Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO. 75-1061

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

JURISDICTIONAL STATEMENT

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I.

JURISDICTIONAL STATEMENT

(a) THE OPINIONS BELOW

The opinion of the Court of Civil Appeals of Alabama is reported in 318 So.2d 719 (advance sheet) and is set forth in the

Appendix A(2), infra.

(b) JURISDICTION

Jurisdiction in this Court is invoked pursuant to 28 U.S.C. § 1257(2), this being an appeal which draws into question the validity of Alabama's statutory, regulatory, and constitutional tax laws, particularly, Regulation 402.2 of the State Department of Revenue promulgated in 1952, Appendix D, infra, and Amendment CCXII to the Alabama Constitution, Act No. 91, Laws 1963, Second Special Session of Alabama, infra, p. 8, on the ground that the same as construed and applied to Appellant, a foreign corporation, is so arbitrary, unreasonable and discriminatory that it is repugnant to the Constitution and laws of the United States.

(i) Nature of the Proceedings

The proceeding originated in the Circuit Court of the Tenth Judicial Circuit of Alabama wherein Appellant (Western), a Delaware corporation doing business in Alabama, and elsewhere, appealed from an additional assessment of income taxes of over $100,000 by the Alabama State

Department of Revenue resulting from the disallowance as a deduction for state income tax purposes of federal income taxes.

Western, an accrual basis taxpayer, correctly and properly accrued and apportioned on its books, at the end of the taxable years in question, its liability for federal income taxes on taxable income of some $7,000,000 earned by it in Alabama. The deduction and apportionment of these taxes were all made in accordance with the provisions of an Alabama Constitutional Amendment providing that ". . . all Federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this State . . ." (Und. ours)

The sole basis for the disallowance of the claimed deductions is the fact that Western paid the amount of the federal taxes due by it to its parent (Diversa), a nonresident Texas corporation, which did no business in Alabama, and joined with its parent in the filing of federal consolidated returns. Diversa having sustained a loss in its interstate operations used this

loss in the federal consolidated returns to offset the income of Appellant earned within the State of Alabama.

Alabama has no consolidated return concept, and no carry-back or carry-forward provisions of profits and losses, as is the case under the Federal tax laws and regulations. Nor did Alabama have any statute or regulation designed in any way to alter, affect or diminish the state constitutional mandate as to the deductibility of federal income taxes by a foreign corporation attributable to the income earned by it in Alabama, in the event it joins in the filing of a federal consolidated return.

(ii) The Rulings of the Courts Below

The trial court in an exhaustive opinion, Appendix A(1), infra, held that the assessment was void as being without statutory, regulatory or constitutional authority. On appeal by the State the Court of Civil Appeals of Alabama, on June 11, 1975, reversed the lower court and rendered a decision in favor of the State. (Appendix A(2)). On July 23, 1975, the

Court of Civil Appeals overruled Appellant's application for rehearing. (Appendix A(3))

On August 7, 1975, Appellant filed a petition in the Supreme Court of Alabama for a writ of certiorari to the Court of Civil Appeals of Alabama. On September 11, 1975, the Supreme Court denied certiorari rendering no opinion. (Appendix B(1)). An application for rehearing was timely filed on August 7, 1975, and on October 30, 1975, the Supreme Court overruled the application for rehearing. (Appendix B(2))

The Notice of Appeal

Although the Court of Civil Appeals is largely in possession of the record in this cause, out of a superabundance of caution a timely notice of appeal to this Court was filed both in the Court of Civil Appeals of Alabama, as well as in the Supreme Court of Alabama on the 21st day of January, 1976. (Appendix C(1) and (2))

(iii) The Statutory Provisions as to Jurisdiction of this Appeal

Appellant challenged the validity of the construction of the Alabama statutory,

regulatory and constitutional provisions, as construed and applied to Appellant, on the ground that it is repugnant to the due process and equal protection clauses of the Constitution and laws of the United States, in each of the courts below, including the Supreme Court of Alabama. The trial court agreed. The Court of Civil Appeals arbitrarily rejected some of Appellant's federal constitutional challenges, and stifled and evaded the vindication of others.

In addition, it upheld the validity of the assessments on such completely inadequate state ground that it properly may be regarded as arbitrary, or a mere device to prevent a review of the decision upon the federal questions presented. Enterprise Irrigation District v. Farmer's Mutual Canal Co., 243 U.S. 157, 61 L.Ed. 644.

The Supreme Court of Alabama, where all federal constitutional challenges were renewed declined to review the holdings of the Court of Civil Appeals.

Accordingly, this matter is appropriately brought to this Court by appeal in accordance with the provisions of 28

U.S.C. § 1257(2). In the event, however, that the Court does not consider this appeal to be the proper mode of review, Appellant respectfully requests that the papers whereon this appeal was taken shall be regarded and acted on as a petition for writ of certiorari, pursuant to 28 U.S.C. § 2103.

(iv) The Cases Sustaining Jurisdiction.

The following cases sustain the jurisdiction of this Court: Hans Ree's Sons, Inc. v. State of North Carolina, 283 U.S. 123, 75 L.Ed. 879; General Motors Corp. v. District of Columbia, 380 U.S. 553, 14 L.Ed.2d 68, 85 S.Ct. 1156; Ivanhoe Irrig. Dist. v. McCracken, 357 U.S. 275, 2 L.Ed.2d 1313, 78 S.Ct. 1174; NAACP v. Alabama, 377 U.S. 288, 12 L.Ed.2d 325, 84 S.Ct. 1302; Palmore v. U.S., 93 S.Ct. 1670, 411 U.S. 389, 36 L.Ed.2d 342; Durley v. Mayo, 351 U.S. 277, 100 L.Ed. 1178, 76 S.Ct. 806; WHYY, Inc. v. Borough of Glassboro, 89 S.Ct. 286, 393 U.S. 117, 21 L.Ed.2d 242; Carl M. Austin v. New Hampshire, 43 L.Ed.2d 530; Allied Stores of Ohio v. Bowers, 358 U.S. 522, 3 L.Ed.2d 480; 79 S.Ct. 437; Wheeling Steel Corp. v. Glander, 337 U.S. 562, 93 L.Ed. 1544; Anno. 100 L.Ed. 1200.

(v) The Validity, Applicability and Construction Of The Following State Statutes Are Here Involved:

Prior to 1963, § 402, Title 51, Code of Alabama, 1940, as supplemented, was in effect. This statute permitted the deduction of federal taxes in computing net income of corporations for Alabama state income tax purposes. On May 8, 1963, the Legislature amended Section 402 by Act No. 107, Vol. 1, 1963 Acts of Alabama, Organizational First Special-Second Special Regular Sessions, 1963, p. 289, so as to exclude federal income taxes as an allowable deduction in computing the net income of corporations subject to Alabama income taxes.

The Constitutional Amendment

On December 10, 1963, a constitutional amendment was adopted by the electorate, which repealed Act No. 107 and which provided as follows:

"CCXII

State tax on net income of corporations.--The legislature shall have

power to levy and provide for the collection of taxes for state purposes on net income of corporations, from whatever source derived, for the calendar year 1963, or for any fiscal year beginning in the calendar year 1963, and each year thereafter, at a rate not exceeding five percent. However, all federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, provided that in the case of foreign corporations the amount of federal income tax deductible shall be in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the legislature may enact." (As proposed by Act 91, Laws, 1963, 2nd Spec.Sess., and adopted at the election of December 10, 1963.) (Und. ours)

Neither the Legislature nor the State Department of Revenue enacted any law or regulation subsequent to the adoption of this constitutional amendment, and during the taxable years here in question, dealing with the apportionment of federal income taxes by foreign corporations.

Other Statutes Remaining in Effect

Nevertheless, the following other

Alabama statutes remained in effect:

§ 402(13), Title 51, Code of Alabama, 1940, as Supplemented:

"(13) In the case of foreign corporations doing business in this state the deductions allowed by this section shall only be allowed if and to the extent that they are connected with income arising from sources within the State of Alabama, and the proper apportionment and allocation of deductions with respect to the sources of income within and without the State of Alabama shall be determined under the rules and regulations prescribed by the department of revenue, provided, that in the case of corporations doing a business partly within and partly without the state where revenue is apportioned or allocated to Alabama the expense in connection with such apportioned or allocated revenue shall be likewise apportioned or allocated to the state, for the purpose of deductions under this title, or the ratio that company expenses in Alabama bear to the company revenues in Alabama."

§376(k) Title 51, Code of Alabama, 1940:

"The term 'paid' for the purpose of deductions and credits hereinafter provided for with respect to income tax means paid or accrued or paid

or incurred, and the term 'paid or incurred' and 'paid or accrued', shall be construed according to the method of accounting on the basis on which the net income is computed under this chapter."

§ 383 Title 51, Code of Alabama, 1940:

"Net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer, ...".

Regulations of the State Department of Revenue

State Department regulations here pertinent are:

Regulation 402.2 promulgated on November 16, 1960 to implement § 402, Title 51, Code of Alabama, 1940, as supplemented, and which, as above stated, permitted the deduction of federal taxes, set out in Appendix D, infra; Regulation 383.3 set out as Appendix E, infra; and Regulation 385(4)2 set out as Appendix F, infra. Finally, Regulation 406.1 which reads as follows:

Reg. 406.1 (¶11-020) of the Department of Revenue:

"Corporation returns.-Each corporation, joint stock company, or association subject to income tax as a corporation shall make a return for each tax year. The return form (Form 20) shall be filled out completely and in accordance with the instructions. The return must be sworn to by the president or other principal officer and by the treasurer or assistant treasurer, and must be notarized...

"It should be observed that consolidated returns of two or more corporations are not permitted by the laws of Alabama, which require that every corporation shall make a return."

(c) QUESTIONS PRESENTED BY THE APPEAL

The following questions are presented by this appeal:

1. Whether the opinion, decision and judgment of the Alabama Court of Civil Appeals construing the words "paid or accrued" appearing in the Alabama Constitutional Amendment CCXII, as applied to Appellant, a foreign corporation, so as to deny Appellant

a deduction for federal income taxes correctly and properly accrued by it on, and correctly and properly apportioned by it to, its income earned in Alabama, at the end of the taxable years in question, solely on the ground that it joined in the filing of a consolidated federal return with a non-resident loss corporation, is so arbitrary and unreasonable that it is repugnant to the due process and equal protection clauses of the 14th Amendment to the United States Constitution and to the laws of the United States for the reasons that:

(i) Such construction results in the constitutionally impermissible imposition of an additional tax upon Appellant which is in no way reasonably related to its income, business or activities earned or carried on in the State of Alabama, but arises solely out of business, property, income, losses or activities of its parent and other affiliated corporations located, earned, incurred and engaged in in interstate commerce outside of the territorial limits of Alabama;

(ii) It violates the basic separation of the taxing powers between the states and

the Federal Government and unconstitutionally injects itself into the taxing powers of the United States, and the privilege granted Appellant under the laws of the United States to freely, and without penalty to be imposed by Alabama for doing so, join in the filing of a federal consolidated tax return with a non-resident affiliated corporation;

(iii) The assessment of additional taxes upon Appellant upheld by the Court of Civil Appeals violates the uniformity, equal protection and due process clauses of the federal constitution for the reason that it was imposed pursuant to a different and more burdensome formula and standard for allowing deductions of federal income taxes to Appellant, as a foreign corporation, than it provides to domestic corporations which compete with Appellant;

(iv) The classification of corporations for state tax purposes based solely upon their joinder in the filing of federal consolidated returns with affiliated loss corporations, which are themselves non-residents of the State of Alabama, and who do not do business there, is constitutionally

impermissible, since it has no valid relation to the income tax laws of Alabama.

(v) The denial of the deduction to Appellant of federal income taxes on the ground that it elected to join in the filing of consolidated federal returns is, for all practical purposes, a constitutionally impermissible penalty, tax or burden on a privilege granted by the United States government under its taxing powers and violates the uniformity, equal protection and due process provisions of the federal constitution;

(vi) The interlacing of the federal consolidated return concept, with its carry-back and carry-forward provisions, with a state tax structure which has no such concept, creates utter confusion in the application of state and federal tax laws, and constitutes a direct interference with the functions of the taxing powers of the federal government and the means used by it in the collection of its taxes.

2. Whether the Alabama State Department of Revenue has the power to implement the Alabama Constitutional mandate to provide a formula for apportionment of federal

taxes to be deducted by foreign corporations where the Alabama Constitution has expressly reserved such power to "such laws which the legislature may enact.", and whether in the absence of such power the assessments against Appellant amount, from a practical standpoint, to the taking of Appellant's property without due process of law.

3. Whether the judgment of the Court of Civil Appeals of Alabama construing the words "paid or accrued" in the Alabama Constitutional Amendment in question to mean "the amount paid from the parent to the IRS" as applied to federal consolidated returns is so contrary to every accepted meaning of the words, as construed by the Supreme Court of Alabama, as well as by every court in the land, including this Court, and as applied to corporations filing separate tax returns, that it constitutes a capricious, arbitrary and deliberate discrimination against those filing consolidated returns, and is repugnant to the due process and equal protection clauses and the laws of the United States.

(a) Whether, as clearly indicated by the decision itself, the holding is

unconstitutional and limited to "every foreign corporation earning income in Alabama . . .", and excludes from its operation their domestic competitors.

4. Whether, the Federal Constitution exacts a uniform application of Alabama's income tax laws to the Appellant and its competitors, and, if so, whether Appellant's federal constitutional rights have been denied as well by the refusal of the state court to decide the question, as by an erroneous decision of it.

5. Whether, even though the claimed constitutional protection be denied on non-federal grounds, it is the province of this Court to inquire whether the decision of the State Court rests upon a fair or substantial basis; and if the purported non-federal ground put forward by the State is unsubstantial and illusory, whether the Appellant is entitled to invoke the jurisdiction of this Court to decide the question.

(a) And, whether the state law, although honestly applied, throws such obstacles in the way of enforcement of federal

rights under the taxing laws and regulations dealing with federal consolidated returns that it must be struck down as unreasonably interfering with the vindication of such rights.

(b) And, finally, whether Appellant "paid or accrued" federal income taxes under the facts here involved presents basically a federal question decided by the State Court which is not binding on this Court.

(d) STATEMENT OF THE CASE AND THE FACTS

(i) Statement of the Case

As previously stated, this case originated in an appeal by Appellant, a foreign corporation doing business in Alabama, instituted in the Circuit Court of Jefferson County, Alabama, from an assessment entered by the State Department of Revenue of additional income taxes for the years 1964, 1965 and 1966, as a result of the disallowance as a deduction of federal income taxes.

The deduction of federal income taxes "paid or accrued" by corporations doing business in Alabama for purpose of

determining the net taxable income for Alabama income tax purposes is expressly allowed all corporations by the constitution of Alabama.

The disallowance of the deduction by the State Department of Revenue was based solely upon the ground that, while the Appellant accrued such taxes on its books at the end of the taxable years in question, and properly apportioned such taxes to the income earned by it in Alabama, the Appellant paid the amount of the federal income taxes so accrued to its parent, instead of to the IRS, and joined with its parent, a non-resident corporation doing business in Texas, and other non-resident affiliated corporations, in the filing of consolidated returns.

The parent sustained losses in Texas, in connection with operations having nothing to do with those of Appellant in Alabama, and used such losses to offset the income of Appellant in Alabama in the filing of the consolidated federal returns.

The trial court held that the State Department of Revenue did not have the power or authority to deny the deductions,

or to determine policy in connection therewith, or to adopt a formula relating to consolidating federal returns which frustrates the Alabama Constitutional provisions, as well as the taxing laws and regulations of the Federal Government dealing with consolidated returns, a concept foreign to the Alabama tax structure. The court further held that under the adjudicated decisions of the Supreme Court of Alabama, and the federal courts, including this Court, Appellant, in fact, "paid or accrued" the federal income taxes disallowed, and declared the assessment null and void.

The Court of Civil Appeals reversed and rendered holding, without any authority to support it, that the words "paid or accrued", as applied to the Appellant joining in the filing of a consolidated return, meant "the amount paid from the parent to the IRS," and that under the federal law, no liability for federal taxes is ever incurred or accrued by a taxpayer who joins in the filing of a consolidated return.

Application for certiorari was made

to the Supreme Court of Alabama and denied.

(ii) Statement of the Facts.

The case below was tried mainly upon written stipulation of the parties. Accordingly, the record shows the following undisputed and clearly established facts as found by the trial court.

(a) That Western, a foreign corporation and a subsidiary of Diversa, was, during the taxable years in question, engaged in the grain milling and feed manufacturing business almost wholly in the State of Alabama. Substantially all of its property, real and personal, and all of its manufacturing activities were located and took place in Alabama. (See p. 4 of Exhibits 1, 2 and 3, R. pp. 213-242).

(b) That at all times material here Western was on the accrual method of accounting, in accordance with sound and generally accepted accounting principles, and reported its income for income tax purposes both to the State of Alabama and to the United

States, using the accrual method of accounting, as required to do so by Regulation 383.3 of the State Department of Revenue, as well as the applicable federal income tax laws and regulations. (R. p. 55, 264);

(c) That for the calendar years ended December 31, 1964, 1965 and 1966, Western duly and timely filed its income tax returns with the State of Alabama, which correctly reflected its taxable income to the State of Alabama. (R. p. 56, 133, 265);

(d) That the income tax returns of Western so filed with the State of Alabama duly, properly and correctly reflected therein the true and correct amount of its individual federal income tax liability to the United States, which federal tax liability Western duly, correctly and properly accrued on its books at the end of each of the taxable years in question, all in accordance with sound and generally accepted accounting principles. (R. p. 57, 133, 264, 265);

(e) That during each of the calendar years in question, Western duly, properly and correctly reflected in each of its income tax returns filed with the State of Alabama that portion of its federal income tax liability so due and accrued which is allocable to, or which is in proportion to, the income derived by Western from sources within the State of Alabama, with a certain exception not material here. (R. 57-58, 133, 265);

(f) That in computing the amount of its income taxable by the State of Alabama during the years in question, Western duly and properly deducted the correct prorata amount of the accrued federal income tax which is allocable to and connected with its income derived from sources within the State of Alabama. (R. pp. 58-59, 133, 266);

(g) That for each of the taxable years in question, and some nine months following the close of these years and some six months after the

filing of the State income tax returns, Western joined with its parent and other non-resident affiliated corporations, none of which did business in the State of Alabama, in filing consolidated United States income tax returns, pursuant to the provisions of Section 1501 et seq. of the Federal Internal Revenue Code and the regulations thereunder. (R. pp. 35, 64, 266);

(h) That in connection with the filing of the consolidated income tax returns, Western prepared and sent to its parent a federal income tax return, which, in all material respects, was identical with the return it would have filed with the Internal Revenue Service had it reported its income on a separate, individual basis, by executing and filing the various forms and documents required to be executed and filed by members of an affiliated group under the provisions of the federal laws and regulations applicable thereto, and that the consoli-

dated returns contained a copy of each of the individual and separate income tax returns of the parent and all of its affiliated corporations, including the plaintiff, as required by federal law and regulation. (R. pp. 64, 65, 266);

(i) That pursuant to an agreement by and between Western and its parent, Western was obligated to pay to its parent all amounts accrued on its books for federal income taxes, based upon its individual liability for such taxes to the federal government, and Western did pay to its parent the amounts of the federal income taxes which were so accrued and which were due and payable by Western to the federal government for each of said calendar years (R. pp. 266, 267, 135). Those amounts were distributed by the parent among the loss corporations which joined in the filing of the consolidated returns. (R. pp. 67, 77);

(j) That during the taxable years in question, Western's parent

and other corporations affiliated therewith, which joined in the filing of the consolidated federal returns, sustained certain losses, which losses were used to off-set the taxable income of Western, as permitted by the provisions of Section 1501, et seq. of the Federal Internal Revenue Code, and the regulations thereunder, and as a result thereof the consolidated group of corporations showed a loss for each of these years. Diversa, as the common parent authorized to file the consolidated returns on behalf of itself and its subsidiaries, paid no federal income tax for those years. (R. pp. 74, 267);

(k) That in 1967 the State Department of Revenue, following an audit of the income tax returns of Western, for each of the calendar years in question, disallowed as a deduction from Western's net taxable income the prorata amount of the federal income taxes so accrued by Western and which were allocable to

and connected with the income of Western derived from sources within the State of Alabama, on the sole ground that while Western accrued the amount of its federal taxes on its books and paid the same to its parent, the parent did not pay the same to the United States at the time of the filing of the consolidated returns for those taxable years. (R. pp. 38, 268);

(l) That the disallowance of the federal income tax deductions resulted in the assessment on March 21, 1968 against Western of additional income taxes in excess of $100,000, and on April 19, 1968, Western paid the amount of such assessments under protest, and on said date Western filed an appeal from such assessments, in full accordance with the laws of Alabama pertaining thereto. (R. pp. 133, 141);

(m) That in the year 1968, during which the final assessments for

additional income taxes were made by the State Department of Revenue against Western and paid by Western, its parent, Diversa, Inc., had substantial earnings in excess of one million dollars and a tax liability in excess of half a million dollars. Under the carry forward and carry back provisions of the Federal Income Tax Laws and Regulations, if no consolidated returns were filed by Diversa, Inc. for the taxable years in question, it would have been able to carry forward the losses sustained by it in the taxable years 1964, 1965 and 1966, and apply the same against its earnings in the year 1968 and thus reduce its taxable income and the amount of taxes thereon to the federal government for that year. (R. pp. 74-77).

(n) That because of the filing of the consolidated returns for the years 1964, 1965 and 1966, such loss carry forward privilege was lost by Diversa, and by the same token, Western, by joining in the consolidated returns during the taxable years in question, lost its opportunity to carry back any losses it might sustain in future years and apply the same against its earnings during the taxable years in question, and thus secure a refund of income taxes which it might have paid had it filed a separate return for those years. (R. pp. 76, 267-268); and

(o) Finally, that the payment by Western to its parent of the federal taxes accrued by it during the taxable years in question, pursuant to the federal statutes and regulations relating to the filing of consolidated federal returns, constituted constructive payment of such taxes by Western to the federal government. (R. pp. 92-3).

(p) Furthermore, upon re-examination of the consolidated return for the year 1964 by the Internal Revenue Service, it was found that the consolidated group instead of showing a loss, owed the government about $84,000. (R. p. 97).

(iii) The Manner in Which the Federal Questions Sought To Be Reviewed Were Raised.

The federal questions sought to be reviewed were raised as follows:

(a) Allegations of the Complaints.

Each of the bills of complaint filed in the Circuit Court, the court of first instance, contained the following allegation with respect to each assessment sought to be invalidated:

> "9. Complainant alleges that the assessment of the Department of Revenue of additional income taxes for the calendar year 1964 1/ is illegal, excessive, void and discriminatory in that:
>
> * * *
>
> "(e) Such assessment is violative of the Fourteenth Amendment to the Constitution of the United States in that it deprives the Complainant of its property without due process of law and denies to Complainant the equal protection of the laws." (R. p. 11, 12, 19, 20, 21, 28, 29 & 30).

1/ The same allegation was made with respect to the assessments for the years 1965 and 1966.

(b) The Prayer for Relief.

Among the prayers for relief set out in each of the complaints is the following:

> "Complainant further prays that this Honorable Court hear the evidence to be submitted in this cause and vacate and set aside said purported final assessment for the calendar year 1964 1/ herein complained of, in accordance with Amendment CCXII of the Constitution of Alabama, § 402(1) and 402(3), Title 51 of the Code of Alabama, 1940, recompiled 1958, Article 1, Sections 6, 13 and 35 of the Constitutions of Alabama, and the Fourteenth Amendment to the Constitution of the United States. Complainant prays for such other and further relief as in equity and good conscience its situation may require."

(c) The Issue Raised in the Answer.

In the answers by the State to paragraph 9 (e) of these respective complaints above quoted, the State averred as follows:

> "(e) The allegations in paragraph (e) are denied and in affirmation of its denial, the respondent avers that the Fourteenth Amendment of the Constitution of the United States has in no way been violated by the assessment of income tax against the respondent." (R. p. 36, 38 & 41)

(d) <u>The Issue That Federal Tax Laws Govern the Right to Accrue Federal Taxes Was Raised</u>.

In the trial of the cause the Appellant propounded the following questions to James Whorton Robertson, a witness for the Appellant who is a certified public accountant employed by Alexander Graham's company and who qualified as an expert in taxation:

"Q. I will ask you to tell the court whether based upon your examination and knowledge of the books and records of Western Grain, whether the federal income tax liabilities shown as having been accrued during each of the years 1964, 1965 and 1966 were correctly and properly so accrued by this corporation during the years in question?

A. Yes." (R. 57)

"Q. You are also familiar with the income tax laws and regulations of the Federal Income Tax Laws and Regulations as they pertain to these tax returns?

A. Yes." (R. 58)

"Q. Now, the accrual method followed by the Plaintiff, I will ask you whether or not it was a proper method and the only method which it could follow in reporting its income both to the state as well

as to the federal government?

A. Yes, that is correct." (R. 58)

"Q. In filing of the consolidated income tax return are the subsidiary corporations or the affiliated corporations required to reflect their income and deductions and the amount of their taxable income as if they were filing a separate return?

A. Yes. But there are a few, you know, additions or deductions."

"Q. A few additions?

A. Yes."

"Q. But does the --

A. As a practical matter, each one has to reflect their own taxable income." (R. 64-65)

"Q. Alright. Now, did Western Grain in this consolidated return reflect as part of the return its taxable income to the federal government?

A. Yes it did." (R. 65)

"Q. Alright. Did Western Grain in the consolidated return reflect its own tax liability to the United States?

A. Yes." (R. 65)

"Q. Which was accrued by it?

A. Yes." (R. 65)

"Q. Was that the same accrued tax liability for federal tax purposes which it reflected in the respective tax returns for the years 1964, 1965 and 1966?

A. Yes it is." (R. 63-66)

The witness then testified that he was familiar with the federal regulations relating to the filing of consolidated tax returns; that each member of the affiliated group of corporations is jointly and severally liable for its own tax liability as well as the tax liability of the group; that under the federal consolidated return concept and the carry-forward and carry-back provisions a balancing process is in operation so that as far as the federal government is concerned a tax which may be deferred in one year is ultimately paid during succeeding years; that Diversa had a tax liability in excess of $500,000 in the year 1968 and that because of the consolidated returns filed in 1964, 1965 and 1966, it was not able to carry back its earnings in 1968. In this connection, the following colloquy took place:

"Q. And because of the consolidated returns that it made in 1964 and 1965

and 1966 it was not able to do that in 1968?

A. That is correct."

"Q. Right. And so is it not a fact that in fact -- and from a practical standpoint what it gained in 1964 was paid to the federal government in 1968?

A. That is correct." (R. 76)

"Q. And again that procedure is completely foreign to the State income tax laws?

A. Yes." (R. 76)

On the question of the propriety of accrual of taxes under the federal taxation laws the witness was asked:

"Q. Mr. Robertson, the federal income tax deducted in these respective state income tax returns for the years 1964, 1965 and 1966 were accrued during those years in accordance with the method of accounting used by the taxpayer in computing taxable income?

A. That is correct." (R. 77)

"Q. That is a little bit -- you mentioned earlier I believe that the filing of the consolidated returns was the filing by the parent in its behalf as well as in behalf of each of the affiliated

groups who joined in that consolidated return; is that true?

A. That is correct." (R. 78)

"Q. I don't know that I made it perfectly clear, I think I did. The amount which was accrued by the Plaintiff-Appellant in this case for federal tax purposes during the years 1964, 1965 and 1966 was the same amount which it would have paid to the federal government had it filed a separate return, separate and apart from the consolidated group?

A. That is correct." (R. 83)

"Q. And the taxpayer, Western Grain, did file all of the forms and consents and agreements required under federal regulations of a member of an affiliated group in connection with the filing of a consolidated return?

A. Yes, they did."

On cross examination the witness was asked whether the Appellant filed a separate return as part of the consolidated returns and paid any tax to the IRS. The following colloquy took place:

"Q. Well, did they pay any during that period of time to the Internal Revenue Service? Did Diversa or Western Grain, did they pay any?

A. If --"

"Q. Will you answer that one question, that is all I asked.

A. Constructively they paid the federal government." (R. p. 92)

"Q. Well, do they file a regular Internal Revenue Service form as though they were making out a separate return that could go into the Internal Revenue Service by itself?

A. It's in effect sort of like that, yes." (R. p. 95)

(e) The Federal Laws Were Invoked.

Many of the federal regulations dealing with consolidated returns were introduced to prove that Appellant properly accrued its tax liability at the end of the taxable years in question, that it incurred a liability to the federal government for such taxes, pursuant to the federal tax laws and regulations, and, that the right of Appellant to accrue Federal taxes was governed by Federal and not State law. (R. p. 66-75)

(f) The Trial Court Recognized And Ruled Upon the Federal Questions Including the Constitutional Issues Raised.

During the trial the Court commented:

"Gentlemen, the point here is I have a number of regulations. I have a number of statutes. I have some constitutional statements that have been made that I am going to have to consider in the light of the stipulated facts . . ." (R. p. 123)

In the opinion of the Trial Court it recognized and ruled upon the rights of Appellant under the Federal Income Tax laws, saying that "the right and obligation of the plaintiff as a separate taxpayer to accrue the amount of federal taxes during the taxable years in question is to be determined by federal law." (Appendix A(1) note 6); and rejected at the insistence of Appellant on federal constitutional grounds the right of Alabama to tax Appellant on the basis of activities, profits or losses sustained by affiliated corporations outside the boundaries of Alabama. (Appendix A(1) note 5)

(g) The Federal Questions were Raised in and Decided by the Court of Appeals

The opinion of the Court of Civil Appeals bristles with federal questions. While reference was made to the Alabama Constitutional Amendment, it is clear that the non-federal ground was neither independent or adequate, and that the decision was based upon the determination of the right of defendant to accrue federal taxes and upon its liability for such taxes to the federal government under the federal laws and regulations dealing with consolidated returns.

The decision makes it clear that the federal issue was essential to its decision. In such case, this court will proceed to determine the case on its merits. Kedroff v. St. Nicholas Cathedral, 344 U.S. 94, 97.

The interpretation that the phrase "paid or accrued" in the Alabama Constitutional Amendment means, "the amount paid from the parent to IRS" is clearly a determination of a federal question. Since the administration of the revenue

laws of the United States are not controlled by state law, such determination is not binding on this court, as we shall subsequently see.

Furthermore, the court dealt with a part of the constitutional question raised by Appellant in its pleadings and in its briefs that the assessments in question violated the due process and equal protection of the laws of the 14th Amendment to the United States Constitution, saying:

> "Western contends that the application of the amendment and regulations in such manner is discriminatory as to corporations who choose to join in consolidated returns and is constitutionally impermissible.
>
> "We are unable to perceive any discrimination. Every foreign corporation earning income in Alabama is taxed the same--upon taxable income after deduction of federal income taxes paid or accrued."

The basic decision of the Court of Appeals involved the construction of the rights and obligations of a taxpayer under the federal consolidated tax returns, as

appears from the following statement:

> "We interpret the phrase 'paid or accrued' contained in the constitutional amendment to mean actually paid or a liability to pay. When filing a consolidated return the tax which would have been paid or accrued by a member had it not joined the group is not determined nor is it necessary to be determined, except as required by the agreement between the parent and the members of the group. No such liability is ever incurred or accrued insofar as the taxing authority is concerned."

Again:

> "Such tax in terms of actual liability to the taxing authority does not accrue. The several liability of the members of the affiliated group extends only to the tax due under the consolidated return."

With respect to the Appellant's contention that Appellant was the only taxpayer before the court and its taxable income in Alabama must be computed in

accordance with the federal laws for determining taxable income of separate corporations, the court held:

> "This quotation was given in support of the proposition that each member of the group consolidated for report of income and payment of taxes is the taxpayer, and the amount of tax computed on its own taxable income and shown as accrued thereon is tax imposed upon it by the United States. We cannot agree such is, in fact, the case."

This is contrary to the decisions of this court, as will be hereafter shown.

(e) THE FEDERAL QUESTIONS HERE INVOLVED ARE SUBSTANTIAL

(i) Alabama has Unconstitutionally Put a Special Burden on Appellant.

Recently, this court, in Austin v. New Hampshire, supra, said that "When a tax measure is challenged as an undue burden on an activity granted as a special constitutional recognition, the appropriate degree of recognition is that necessary to the maintenance of our constitutional federalism.

The delicate balance between the constitutional separation of the federal and state for powers is here involved.

While Austin involved the infringement of the privileges and immunities of citizens, its rationale is equally applicable to the equal protection of the laws under the 14th Amendment to which the Appellant is entitled against "an improper basis for locating a special burden."

This is not a case of occasional or accidental inequality due to circumstances peculiar to the Appellant. The decision in question on its face places a special burden on foreign corporations, as distinguished from domestic corporations, and operates to the disadvantage of such corporations doing business in Alabama, which exercise the federal privileges under consolidated tax returns.

As was indicated by the Court of Civil Appeals of Alabama, it has already decided a similar case against Standard Oil Company of Kentucky. There are literally numbers and numbers of cases now pending before the State Department of Revenue

involving the same issues and awaiting the determination of this cause by this court.

It is reasonable to assume that, unless this decision is reversed by this court, other states will seize upon this decision to likewise discriminate against foreign corporations in their jurisdictions.

(ii) The Erroneous Rationale of the Alabama Court Affects Other Areas of Federal Tax Laws.

The federal question here involved not only affects deduction of federal taxes by foreign corporations filing consolidated returns, but also the exemptions to which non-resident individuals filing joint returns are entitled. See, for instance, State v. Burnett, 140 S.W. 2d 673, in which the State contended that the incomes of both husband and wife should be taken into consideration for the purpose of determining the amount of exemption to which the non-resident wife was entitled and in which the court said:

> "The net income of Appellee's husband derived from sources outside the State of Arkansas should not have been taken into account by the Commissioner of Revenue in allowing the exemptions."

It arises also in determining state taxes in cases involving the net operating loss carry-back provisions under the federal income tax laws (Tennessee Aircraft v. Evans, 229 S.W. 2d 499 [Tenn.]), where the state sought to increase the net earnings of a taxpayer because of the deduction of federal taxes subsequently refunded, where the court said:

> "This refund, which follow the contingency brought about by future losses, was entirely a plan of the federal government by which refunds were made. To interlace the collection of excise taxes with contingencies that might arise from time to time under the net operating loss carry-back provisions of the federal income tax laws would serve to bring about confusion in the administration of the state excise tax law, Code, §1316 et seq., and we do not think such condition was ever contemplated by the legislature."

The federal question here involved,

also touches State Tax Commissions' formulae for computing taxpayers' federal tax deductions for state income tax purposes involving foreign tax credits. See, Anderson Clayton & Co. v. Dwitt, 513 Pac. 2d 1357 (Ariz.).

(iii) The Exact Issue was Decided in favor of Appellant in the following cases:

The Supreme Court of Kansas in Cities Service Gas Company v. McDonald, 466 F.2d 277, rejected as unsound every contention advanced by the Alabama Intermediate Court of Appeals, saying:

"Under the procedure followed here, the parent company acted simply as a clearing house in collecting tax monies from those of its subsidiaries having taxable income and in refunding and paying out to its loss subsidiaries the amounts to which they were entitled by reason of their loss credit having been utilized in the consolidation return. No gain actually resulted to the parent. Just the same, a tax liability was incurred and paid by the gas company. Its tax liability

was reported and paid to the parent company, and the consolidated return reflected the tax liability in the same amount as had an individual return been filed." (Und. ours.)

The Alabama Department of Revenue relied on Truckline Gas Co. v. Collector of Revenue, 182 So.2d 674 (La. App. 1965) which involved a similar question relating to the effect on state taxes of the filing of consolidated federal returns, which the Kansas court rejected as unsound, but which the Alabama Court of Appeals took to its bosom in deciding the case of Standard Oil Company of Kentucky referred to in its decision.

This illustrates the nationwide confusion and importance of the federal question involved, and this court should view this conflict in the state decisions, for the purpose of determining whether this cause should be reviewed, in the same light as in the case of a conflict between the federal circuits, since the conflict relates to federal law which has not been previously decided by this

Court.

The converse of this question took place in Sinclair Manufacturing Co. v. Gilpatric, 118 Atlantic 919 (Conn.), wherein a corporation doing business within the state joined in the filing of a consolidated return with affiliated corporations which were not engaged in business within the state, and as a result of the offsetting of losses against profits, the consolidated group was not required to pay a federal tax. The taxpayer claimed it had no income subject to state taxation. The court held:

> "...that in the computation of net income for purposes of taxation in Connecticut the deductions and credits allowed by the federal law, and which would be given in ascertaining the net income of such corporation, separately computed for purposes of federal taxation, must be allowed in computing net income for the purpose of taxation under the Connecticut statute,..."

It is clear, therefore, that the question presented is so substantial as to require plenary consideration by this court.

(iv) The Rulings of the Court are not Based on Adequate State Ground.

Neither the Alabama Constitutional Amendment nor any statute, nor any regulation of the State Department of Revenue requires that federal taxes be both paid and accrued in order to be deductible for state income tax purposes. They provide to the contrary. The judicial decisions of the Supreme Court of Alabama have ruled to the contrary. The First National Bank v. State, 29 So. 2d 673, 249 Ala. 68; Clark v. State, 51 So. 2d 882, 255 Ala. 431; State v. Yellow Pine Lumber Co., 83 So. 2d 317, 263 Ala. 613.

Consolidated returns are specifically prohibited in Alabama. (Reg. 406.1 of the Department of Revenue.)

Alabama recognizes, as indeed it must, that the question whether a tax is imposed as such by the United States is governed by federal law and the decision of the United

Supreme Court. Sloss v. State, 89 So. 2d 174, 264 Ala. 680.

The basic formula for the apportionment of federal taxes by a foreign corportion is clearly spelled out in the Alabama Constitution, which is that they "shall be in proportion to income derived from sources within Alabama." The State Department of Revenue cannot adopt a formula or policy which is outside the framework of the constitution and laws of the state. (State v. Travelers Insurance Co., 37 So. 2d 745, 256 Ala. 61; General Motors Corp. v. District of Columbia, 380 U. S. 553, 14 L. Ed. 2d 68, 85 S.Ct. 1156.)

Accordingly, it is clear that the judgment of the Court of Civil Appeals of Alabama cannot be said to rest on a fair or adequate state ground.

(v) The Court has Erroneously Decided a Federal Question Relating to the Federal Revenue Laws.

The administration of federal taxing laws is a federal function not controlled by state law or decisions.

It is likewise well settled that if the independent state ground was not a substantial or sufficient one, it may be pre-

sumed that the state court based its judgment on the law raising the federal question and this court will then take jurisdiction. Durley v. Mayo, 351 U.S. 277, 100 L. Ed. 1178, 76 S.Ct. 806.

Furthermore, the Appellant's constitutional rights are denied as well by the refusal of the state court to decide the question as by an erroneous decision of it. Larwin v. State Tax Commission, 286 U.S. 276, 76 L. Ed. 1102.

The words "paid or accrued" under the Alabama Constitution, insofar as the deduction of federal income taxes is concerned, means, according to the decision of this court, that the tax accrues when the liability arises at the end of the taxable year, although not yet due and payable, and although it is not in fact subsequently paid. Lewyt Corp. v. Commissioner, 348 U.S. 237, 99 L. Ed. 1029; U. S. v. Olympic Radio and Television, 349 U.S. 232, 99 L. Ed. 1024.

(vi) The Decision is Repugnant to the Due Process and Equal Protection Clauses of the 14th Amendment to the Constitution of the United States

To avoid violation of the Equal Protection Clause of the 14th Amendment, a state's tax laws must proceed upon a rational basis and a state may not resort to a classification that is palpably arbitrary. To charge a foreign corporation a greater income tax than a domestic corporation on the sole ground that it has paid its federal taxes to its parent who files a consolidated federal return bears no reasonable relation to the tax laws of Alabama, and does not rest upon some sound difference having a fair and substantial relation to such tax laws. Allied Stores of Ohio v. Bowers, 358 U.S. 522, 3 L.E. 2d 480; Wheeling Steel Corporation v. Gland, 337 U.S. 562, 93 L.A. 1544.

Alabama may not constitutionally levy a tax on taxpayers, based on income earned or activities conducted outside the state. Hans Rees Sons of North Carolina, 283 U.S. 123, 75 Law Ed. 879, Annotation 167 A.L.R. p. 944.

Alabama may not tax a foreign corporation on the sole ground that it joins in the filing of a federal consolidated return with affiliated loss corporations, nor may it do so indirectly by denying it a deduction otherwise provided by law. General Motors Corp. v. District of Columbia, 380 U.S. 553, 14 Law. Ed. 768, 85 Sup. Ct. 1156.

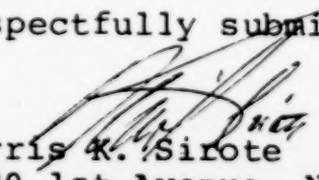
The classification of foreign corporations joining in the filing of federal consolidated returns with affiliated loss corporations for special tax treatment constitutes an impermissible interference with the taxing powers of the federal government. McCullough v. Maryland, 4 Wheaton 316, 4 Law Ed. 579, Fox Film Corp. v. Doyal, 76 Law Ed. 1010, 286 U.S. 132; James v. Dravo Contracting Co., 82 Law Ed. 155, 302 U.S. 134; New Jersey Bell Telephone Co. v. State Board of Taxes, 280 U.S. 338, 74 Law Ed. 463.

CONCLUSION

This appeal raises an issue of fundamental importance to the administration of the tax laws of the state and federal governments, and to the constitutional separation of federal and state powers. It invokes also the continuing concern of this court over the years in scrutinizing state taxing statutes to insure that the methods used to tax foreign corporations display a reasonable relation to corporate activities within the state, and that the income of such corporations doing business within and without the state be properly and fairly apportioned.

For the foregoing reasons, probable jurisdiction should be noted.

Respectfully submitted,



Morris K. Sirote
2030 1st Avenue, North
Birmingham, Alabama 352(
Attorney for Appellant

PROOF OF SERVICE

I, Morris K. Sirote, one of the attorneys for Western Grain Company, Appellant herein, and a member of the Bar of the Supreme Court of the United States, do hereby certify that on the 25th day of January, 1976, I served copies of the above and foregoing Jurisdictional Statement, together with Appendices thereto, by mailing and depositing the same in a United States Post Office or mail box, with first class postage prepaid, in a duly addressed envelope, to Messrs. William J. Baxley, Attorney General of Alabama, Willard W. Livingston, Counsel, Department of Revenue and Assistant Attorney General of Alabama, and upon Herbert I. Burson, Jr., Assistant Counsel, Department of Revenue and Assistant Attorney General of Alabama, counsel of record for the State of Alabama, at their Post Office addresses, 201 Administrative Building, Montgomery, Alabama.

It is further certified that all parties required to be served have been served.

This the 26th day of January, 1976.

Morris K. Sirote,
Attorney for Western
Grain Company, Appellant
2030 1st Avenue, North
Birmingham, Alabama 35203

APPENDIX A(2)

THE STATE OF ALABAMA

JUDICIAL DEPARTMENT

THE COURT OF CIVIL APPEALS

OCTOBER TERM 1974-1975

Civ. 525, 525A, 525B

State of Alabama

v.

Western Grain Company,
A Corporation

Appealed From
The Jefferson County Circuit Court

WRIGHT, Presiding Judge

This is an appeal by the Department of Revenue from a decree of the Circuit Court of Jefferson County, which decree set aside an assessment of income taxes against Western Grain Company for the years 1964, 1965 and 1966. We reverse.

There are three cases, one for

each tax year, which were consolidated for trial and this appeal. Substantially the same issues of law are involved here as were considered by this court in the recent case of Standard Oil of Kentucky (Kyso) v. State, _____ Ala. _____, _____ So.2d _____ [Ms. Civ. 526] March 5, 1975. Certiorari was denied by the Supreme Court on May 22, 1975. We find that disposition of this case is controlled by our decision in Kyso except for the issue of constitutionality which we will discuss later in this decision.

The facts giving rise to the dispute are as follows: Western Grain Company, hereafter called Western, is a foreign corporation doing business largely in Alabama. The parent corporation of Western is Diversa, Inc. For the years involved Western filed its state income tax return showing taxable income from

all sources including that from business done in Alabama. On such returns it deducted from taxable income the amount shown on its books as accrued federal income tax.

There is no dispute as to the correctness of the amount of taxable income or the amount shown as accrued federal income tax thereon.

The dispute involved arose solely over whether the amount shown by the books of Western as accrued federal income tax is deductible from taxable income in determining the income tax due the State.

The taxing authority of the State in this case is derived from Constitutional Amendment CCXII adopted December 10, 1963 which is as follows:

> "State tax on net income of corportions.--The legislature shall have power to levy and provide for the collection of taxes for state purposes on net income of

corporation, from whatever source derived, for the calender year 1963, or for any fiscal year beginning in the calender year 1963, and each year thereafter, at a rate not exceeding five percent. However, all federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, provided that in the case of foreign corporations the amount of federal income tax deductible shall be in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the legislature may enact." (As proposed by Act 91, Laws, 1963, 2nd Spec. Sess., and adopted at the election of December 10, 1963.) (Emphasis supplied.)

Had Western filed an individual federal income tax return there would be no problem before us. It did not do so in fact. It joined with its parent corporation and other affiliated subsidiaries in filing a consolidated federal return under 26 U.S.C.A. §§ 1501-2. The procedure used by the Diversa group in filing such consolidated return may be succinctly described as follows: Each affiliated corporation prepared its statement of taxable income showing federal tax thereon as if it were filing a separate return. This statement was forwarded to the parent corporation together with a consent form for the filing on its behalf by the parent. The parent combined the income statements of the affiliated corporations and determined the tax due on the total. According to treasury regulations, if one or more affiliates have taxable income and others show losses, such income is offset by the losses and tax is paid on any remaining taxable income. Carry-over or carry-back privileges are permitted. The consolidation in this case resulted in loss of taxable income and thus no federal income tax was paid by the parent corporation.

By agreement between the parent,

Diversa, and its affiliates, any corporation having taxable income and which would have had a federal income tax liability thereon if filing a separate return, paid the amount of such liability to the parent at the time it filed its income statement with the parent. After payment of the tax, if any, on the consolidated returns, such payment was disbursed to the affiliated corporations in ratio to their losses for the period, if any.

For the years involved, Western paid to the parent corporation the sum which it had calculated was due as tax on its taxable income as if filing a separate return. It showed this sum on its books as accrued tax. Western then claimed such sum as a deduction for paid or accrued federal income tax on its Alabama income tax return. The Department or Revenue denied such claim as a deduction,

saying in effect that Western neither paid nor accrued any federal income tax due to it joining in the consolidated return. Final assessment was made by the State after contest by Western. Western paid the assessment and appealed to the Circuit Court of Jefferson County. That court set the assessment aside and ordered refund of the assessment. The State appeals here.

This court in the Kyso case held that amendment CCXII to the Alabama Constitution is to be construed in light of statutes and regulations relating to the same subject, i.e., Title 52, Sec. 402 (13), Regulation 402.2, deductions of federal income taxes. We said,

> "....We interpret the phrase 'paid or accrued' to mean the amount paid from the parent to the IRA....To this court no federal income taxes were actually 'paid' or 'accrued' by Kyso by the filing of an accounting statement with Socal."

We follow our construction of Amendment CCXII in Kyso in this case. Though Western, in bookkeeping terms, accrued on its books a calculated federal income tax which it would have been due to pay had it not chosen to use the consolidated return, it, in fact, did not pay such sum to the Internal Revenue Service nor did it incur liability for such payment. Such tax in terms of actual liability to the taxing authority did not accrue. The severable liability of the members of the affiliated group extends only to the tax due under the consolidated return. IRS Reg. Sec. 6(a) 1.1502.

Appellee quotes from Vol. 8A, Mertens Law of Federal Income Taxation, Sec. 46.77, as follows:

> "In computing separate taxable income of a member for use in the computation of consolidated taxable income under Regulation 1.1502-11 the starting point is

> a computation in accordance with the provisions for determining taxable income of separate corporations, with a number of specified exceptions."

This quotation was given in support of the proposition that each member of the group consolidated for report of income and payment of taxes is the taxpayer and the amount of tax computed on its own taxable income and shown as accrued thereon is tax imposed upon it by the United States. We cannot agree such is, in fact, the case. Of course, the beginning point of a consolidated return is the sum of the taxable income of each member. Such is the case in the consolidated or joint return of a husband and wife. The taxable income of a group cannot be computed without first determining the taxable income of each member thereof. Each member of the group is a reporting unit insofar as its taxable income is determined, and all

are severally liable for the tax due under the consolidated return, but there is no liability incurred, paid or accrued by a member of the group according to its separate taxable income. Removal of such liability is one of several benefits derived from joining in a consolidated return.

We interpret the phrase "paid or accrued" contained in the constitutional amendment to mean actually paid or a liability to pay. When filing a consolidated return the tax which would have been paid or accrued by a member had it not joined the group is not determined nor is it necessary to be determined, except as required by the agreement between the parent and the members of the group. No such liability is ever incurred or accrued insofar as the taxing authority is concerned.

Western contends that the appli-

cation of the amendment and regulations in such manner is discriminatory as to corporations who choose to join in consolidated returns and is constitutionally impermissible.

We are unable to perceive any discrimination. Every foreign corporation earning income in Alabama is taxed the same--upon taxable income after deduction of federal income taxes paid or accrued. The decision to join in a consolidated return for federal income taxes or file a separate return is that of the taxpayer. Filing a consolidated return is a privilege and results in a consolidated tax liability. 26 U.S.C.A. §1501. If it benefits in relief from federal taxes it may cost in the amount of deductions permitted by the State. Such results in a penalty by choice of the taxpayer. It is not discrimination by

the State. We are cited to no case in point to the contrary.

On authority of Kyso v. State we reverse the judgment of the circuit court and render judgment in favor of the State.

REVERSED AND RENDERED

BRADLEY and HOLMES, JJ. Concur.

I, John H. Wilkerson, Jr., Clerk of the Court of Civil Appeals of Alabama, do hereby certify that the foregoing is a full, true and correct copy of the instrument(s) herewith set out as same appears of record in said Court.

Witness my hand this 11th day of June, 1975.

John H. Wilkerson, Jr.
Clerk, Court of Civil Appeals of Alabama

APPENDIX A(3)

June 11, 1975

STATE OF ALABAMA- - --JUDICIAL DEPARTMENT

COURT OF CIVIL APPEALS

OCTOBER TERM 1974-75

Civ. 525, 525A, 525B	*	
State of Alabama	*	
v.	*	JEFFERSON
Western Grain Company, a corporation	*	CIRCUIT COURT

This cause having been submitted, IT IS CONSIDERED, ORDERED, ADJUDGED AND DECREED that the decree of the Circuit Court be reversed and annulled and this Court proceeding to render the judgment that the Circuit Court should have rendered new ORDERS AND ADJUDGES that the decree be, and the same is hereby rendered for the defendant; and that the defendant recover of the plaintiff the costs expended in this behalf, for which costs let execution issue.

IT IS FURTHER ORDERED that the appellee, Western Grain Company, a Corporation, pay the costs accruing on said appeal in this Court and in the Court below, for which costs let execution issue.

Opinion by Wright, P. J.
Bradley and Holmes, JJ., concur

I, John H. Wilkerson, Jr., Clerk of the Court of Civil Appeals of Alabama, do hereby certify that the foregoing is a full, true and correct copy of the instrument(s) herewith set out as same appears of record in said court.

Witness my hand this 21 day of Jan. 1976.

John H. Wilkerson, Jr.
Clerk, Court of Civil
Appeals of Alabama

APPENDIX A(4)

JULY 23, 1975

STATE OF ALABAMA- - - JUDICIAL DEPARTMENT

COURT OF CIVIL APPEALS
SPECIAL TERM 1974-75

RULING ON APPLICATION FOR REHEARING

Civ. 525 525-A 525-B	*	
State of Alabama	*	JEFFERSON
v.	*	CIRCUIT COURT
Western Grain Company	*	

IT IS ORDERED that the application for rehearing filed on June 26, be and the same is hereby overruled.

I, John H. Wilkerson, Jr., Clerk of the Court of Civil Appeals of Alabama, do hereby certify that the foregoing is a full, true and correct copy of the instrument(s) herewith set out as same appears of record in said court.

Witness my hand this 21 day of Jan. 1976.
John H. Wilkerson, Jr.
Clerk, Court of Civil Appeals of Alabama

APPENDIX B(1) & (2)

SEPTEMBER 11, 1975
THE STATE OF ALABAMA-JUDICIAL DEPARTMENT

IN THE SUPREME COURT OF ALABAMA
SPECIAL TERM 1975

SEPTEMBER 11, 1975

SC 1399

EX PARTE: WESTERN GRAIN COMPANY

PETITION FOR WRIT OF CERTIORARI
TO THE COURT OF CIVIL APPEALS

(RE: STATE OF ALABAMA V.
WESTERN GRAIN COMPANY)

The Petition for Writ of Certiorari to the Court of Civil Appeals being duly submitted to this Court, it is CONSIDERED AND ORDERED that the petition be denied, at the costs of the petitioners, for which costs let execution issue.

OCTOBER 30, 1975

SC 1399

EX PARTE: WESTERN GRAIN COMPANY

PETITION FOR WRIT OF CERTIORARI
TO THE COURT OF CIVIL APPEALS

(RE: STATE OF ALABAMA V.
WESTERN GRAIN COMPANY)

IT IS ORDERED that the application for rehearing filed in this cause on September 26, 1975, be, and the same is hereby, overruled.

I, J. O. Sentell, Clerk of the Supreme Court of Alabama, do hereby certify that the foregoing is a full, true and correct copy of the instrument(s) herewith set out as same appears of record in said Court.

Witness my hand this 21 day of Jan. 1976.

J. O. Sentell
Clerk, Supreme Court of
Alabama

APPENDIX C(1)

IN THE COURT OF CIVIL APPEALS

STATE OF ALABAMA

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

Nos. Civ. 525-525-A-525-B

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Western Grain Company, a corporation, the Appellant above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Civil Appeals, State of Alabama, entered in this action on June 11, 1975, and reported in 318 So. 2d 719, in that certain appeal in that court numbered and styled, State of Alabama, Appellant, v. Western

Grain Company, Appellee, Civ. 525-525-A-525-B, which final judgment reversed and rendered the decision and judgment of the Jefferson County Circuit Court.

Notice is hereby further given that the said Western Grain Company further appeals from the final judgment of the Supreme Court of Alabama denying certiorari to review and revise the said final judgment of the Court of Civil Appeals of Alabama, entered in this action on September 11, 1975, on which application for rehearing was denied on October 30, 1975.

This appeal is taken pursuant to 28 U.S.C. § 1257 (2).

Morris K. Sirote

Morris K. Sirote, Attorney
for Western Grain Company,
Appellant
2030 First Avenue North
Birmingham, Alabama 35203

Filed in Court January 22, 1976.

APPENDIX C(2)

IN THE COURT OF CIVIL APPEALS
STATE OF ALABAMA

WESTERN GRAIN COMPANY,
a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

Nos. Civ. 525-525-A-525-B

PROOF OF SERVICE

I, Morris K. Sirote, one of the attorneys for Western Grain Company, Appellant herein, and a member of the Bar of the Supreme Court of the United States, do hereby certify that on the 21st day of January, 1976, I served copies of the above and foregoing Notice of Appeal to the Supreme Court of the United States from the final judgment of the Court of Civil Appeals of Alabama and from the final judgment of the Supreme Court of Alabama, as above set out, by mailing and depositing the same in a United States Post Office or mail box, with first class postage prepaid, in a duly addressed envelope, to Messrs. William J. Baxley, Attorney General of

Alabama, Willard W. Livingston, Counsel, Department of Revenue and Assistant Attorney General of Alabama, and upon Herbert I. Burson, Jr., Assistant Counsel, Department of Revenue and Assistant Attorney General of Alabama, counsel of record for the State of Alabama at their Post Office addresses, 201 Administrative Building, Montgomery, Alabama.

It is further certified that all parties required to be served have been served.

This the 21st day of January, 1976.

Morris K. Sirote

Morris K. Sirote, Attorney
for Western Grain Company,
Appellant
2030 First Avenue North
Birmingham, Alabama 35203

APPENDIX C(1)

IN THE

SUPREME COURT OF ALABAMA

WESTERN GRAIN COMPANY,
a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

Nos. Civ. 525-525-A-525-B

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Western Grain Company, a corporation, the Appellant above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Civil Appeals, State of Alabama, entered in this action on June 11, 1975, and reported in 318 So.2d 719, in that certain appeal in that court numbered and styled, State of Alabama, Appellant, v. Western Grain Company, Appellee, Civ. 525-525-A-525-B, which final judgment reversed and rendered the decision and judgment of the Jefferson County Circuit Court.

Notice is hereby further given that the said Western Grain Company further

appeals from the final judgment of the Supreme Court of Alabama denying certiorari to review and revise the said final judgment of the Court of Civil Appeals of Alabama, entered in this action on September 11, 1975, on which application for rehearing was denied on October 30, 1975.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Morris K. Sirote

Morris K. Sirote, Attorney
for Western Grain Company,
Appellant
2030 First Avenue North
Birmingham, Alabama 35203

Filed in Court January 22, 1976.

APPENDIX C(2)

IN THE
SUPREME COURT OF ALABAMA

WESTERN GRAIN COMPANY,
a corporation,

Appellant

v. **No. SC 1399**

STATE OF ALABAMA,

Appellee

PROOF OF SERVICE

I, Morris K. Sirote, one of the attorneys for Western Grain Company, Appellant herein, and a member of the Bar of the Supreme Court of the United States, do hereby certify that on the 21st day of January, 1976, I served copies of the above and foregoing Notice of Appeal to the Supreme Court of the United States from the final judgment of the Court of Civil Appeals of Alabama and from the final judgment of the Supreme Court of Alabama, as above set out, by mailing and depositing the same in a United States Post Office or mail box, with first class postage prepaid, in a duly addressed envelope, to Messrs. William J. Baxley,

Attorney General of Alabama, Willard W. Livingston, Counsel, Department of Revenue and Assistant Attorney General of Alabama, and upon Herbert I. Burson, Jr., Assistant Counsel, Department of Revenue and Assistant Attorney General of Alabama, counsel of record for the State of Alabama at their Post Office addresses, 201 Administrative Building, Montgomery, Alabama.

It is further certified that all parties required to be served have been served.

This the 21st day of January, 1976.

Morris K. Sirote

Morris K. Sirote, Attorney
for Western Grain Company,
Appellant
2030 First Avenue North
Birmingham, Alabama 35203

APPENDIX D

"Reg. 402.2...A foreign corporation doing business in Alabama is entitled to the same deductions allowed a domestic corporation, but only to the extent that they are connected with income arising from sources within the State. A corporation having income from multistate operations may apportion its income in accordance with Reg. 398.2 in which case allowable deductions must also be apportioned in the same manner; or such corporation may adopt a method of separate accounting, in which case the deductions allowable shall be those applicable to income arising from sources within the State of Alabama.

"Where a corporation operates both within and without Alabama ..., [t]he amount of Federal income tax allocated to Alabama should be determined by the ratio that the net income from sources within Alabama bears to the total net income from all sources as shown by the Federal income tax return. The Federal income tax to be apportioned in this matter is the tax accrued as swhon by the final Federal income and excess profits tax return of the taxpayer and reduced by any refund allowed and given during the tax year under the Federal statute . . . ."

Supreme Court, U. S.
FILED
JAN 28 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO. 75-1061

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

SUPPELEMENTAL JURISDICTIONAL STATEMENT

Morris K. Sirote
2030 First Avenue No.
Birmingham, Alabama
Counsel for Appellant

Of Counsel:
Sirote, Permutt,
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2030 First Avenue No.
Birmingham, Alabama

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO._____

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

SUPPELEMENTAL JURISDICTIONAL STATEMENT

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. _____

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

I.

SUPPLEMENTAL JURISDICTIONAL STATEMENT

By inadvertence, the following subsection (vii) to Section (e) titled "THE FEDERAL QUESTIONS HERE INVOLVED ARE SUBSTANTIAL" was omitted, and Appellant begs

leave to file the following Supplemental Jurisdictional Statement so as to include subsection (vii) as follows:

(vii) The Decision Misconstrues the Federal Consolidated Returns Concept.

The entire thrust of the decision of the Court of Civil Appeals of Alabama is that "had Western filed an individual federal income tax return there would be no problem before us." The Court further erroneously reasons that under the federal law, no liability for federal taxes exists or can be accrued by a corporation at the end of its taxable year, if it subsequently joins in the filing of a consolidated return with its parent and other affiliated corporations. "The several liability of the members of the affiliated group", said the Court, "extends only to the tax due under the consolidated return."

The quick answer to this lies in the following two established principles of federal law:

1. A corporation filing a consolidated federal return with an affiliated group of corporations continues to be the

only taxable unit; the consolidated return operates to unite them only for the purpose of tax computation of the group; and each corporation continues to be liable as a separate taxpayer for its own taxable income as well as the consolidated income of the group. Helvering v. Morgan's, 79 L.Ed. 232, 293 U.S. 121; Wolford Realty Company v. Rose, 76 L.Ed. 1128, 286 U.S. 319; United States v. Donaldson Realty Company, Inc., 106 F.2d 509 (8th Circuit); Commissioner of Internal Revenue v. Ginsburg, 54 F.2d 238; Royal Indemnity Co. v. United States, 120 F.2d 136 (6th Circuit); 26 USCA § 1501-1502; Federal Regulations 1.1502-11, 12, 15, 16.

2. The joinder by Western in the filing of the consolidated federal returns and the filing by it of appropriate documents incorporated in the consolidated returns, showing its own income and expenses and its own liability for federal income taxes during the taxable years in question, constituted the filing by it of its own final federal and excise profits tax returns. Woolford Realty Co. v. Rose, 286 U.S. 319, 76 L.Ed. 1128; Continental

Oil Co. v. Helvering, 100 F. 2d 101; Dorrance v. Phillips, 85 F2d 860; Commissioner of Internal Revenue v. Van Camp Packing Co., 67 F.2d 596; Fire Companies Building Corp. v. Internal Revenue Service, 54 F.2d 488; Texas Pipe Line Co. v. U.S., 58 F.2d 852, cert. den., 288 U.S. 604, 77 L.Ed. 979; Swift & Co. v. U.S., 38 F.2d 365; 47 C.J.S. Internal Revenue § 648; Fed. Reg. §1.1502-75, 76, 77, 78, 79 and 80; §§ 1501 and 1502 of the Internal Revenue Code.

It would be strange law indeed if a state could look solely to the federal consolidated return for the purpose of determining the tax deductions to which a member of the affiliated group, subject to its tax laws, is entitled, but then ignore the consolidated return and look solely to the individual liability of the corporation, as a separate taxpayer, for the purpose of determining its taxable income.

Respectfully submitted,

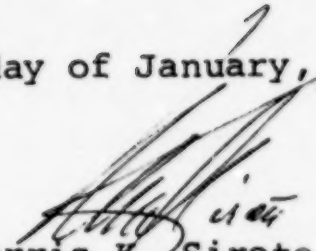
Morris K. Sirote
2030 1st Avenue North
Birmingham, Alabama
Attorney for Appellant

PROOF OF SERVICE

I, Morris K. Sirote, one of the attorneys for Western Grain Company, Appellant herein, and a member of the Bar of the Supreme Court of the United States, do hereby certify that on the 27th day of January, 1976, I served copies of the above and foregoing Supplemental Jurisdictional Statement, by mailing and depositing the same in a United States Post Office or mail box, with first class postage prepaid, in a duly addressed envelope, to Messrs. William J. Baxley, Attorney General of Alabama, Willard W. Livingston, Counsel, Department of Revenue and Assistant Attorney General of Alabama, and upon Herbert I. Burson, Jr., Assistant Counsel, Department of Revenue and Assistant Attorney General of Alabama, counsel of record for the State of Alabama, at their Post Office addresses, 201 Administrative Building, Montgomery, Alabama.

It is further certified that all parties required to be served have been served.

This the 27th day of January, 1976.



Morris K. Sirote,
Attorney for Western
Grain Company, Appellant
2030 1st Avenue, North
Birmingham, Alabama 35203

Supreme Court, U. S.
FILED
JAN 27 1976
MICHAEL RODAK, JR., CLERK

APPENDIX A(1)

OPINION OF TRIAL COURT

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO. 75-1061

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

JURISDICTIONAL STATEMENT

Morris K. Sirote
2030 First Avenue No.
Birmingham, Alabama
Counsel for Appellant

Of Counsel:
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Birmingham, Alabama

APPENDIX A(1)

WESTERN GRAIN COMPANY, a corporation, Plaintiff-Appellant	IN THE CIRCUIT COURT TENTH JUDICIAL CIRCUIT OF ALABAMA
vs.	CIVIL CASE NOS. 151-493 - 151-494 151-495
THE STATE OF ALABAMA, Defendant-Appellee	(Formerly in Equity)

FINAL DECREE

This cause having been submitted to the Court for final decree upon the written stipulation of the parties and the oral testimony and exhibits introduced in open court by both parties, and the Court having duly considered the same and the written Briefs filed by each party hereto, now makes the following findings of fact and conclusions of law, and renders judgment accordingly.

Findings of Fact.

1. These are three actions by the plaintiff, Western Grain Company, a corporation ("WESTERN"), against the State

of Alabama to recover certain sums assessed against it by the State Department of Revenue as additional income taxes for the calendar years 1965, 1965 and 1966 (taxable years in question), and paid to the State under protest. They come to this Court on appeal duly filed by plaintiff from each of said final assessments, pursuant to provisions of Section 140, Title 51, Code of Alabama 1940, recompiled 1958, notices of which were duly filed with the Register of this Court and with the State Department of Revenue, and all other proceedings and actions necessary to perfect said appeals were duly and timely taken by plaintiff, as required by law. All three actions have been consolidated for trial, and for the rendition of a single decree.

2. WESTERN, a Delaware corporation, was during the taxable years in question engaged in the grain milling business; milling, manufacturing and selling mixed feeds and grain products in the State of Alabama as well as outside Alabama. At all times material here WESTERN was on the accrual method of accounting, in accordance with sound and generally accepted accounting principles, and reported its income for income tax purposes both to the State of Alabama and to the United States, using the accrual method of accounting, as required to do so by Reg. 383.3 of the State Department of Revenue, as well as the applicable Federal income tax laws and regulations.

3. For the calendar years ended December 31, 1964, 1965 and 1966, WESTERN duly and timely filed its income tax

returns with the State of Alabama, showing a taxable income, derived from sources within as well as without the State of Alabama, amounting to the sums of $947,708.97, $2,263,541.40 and $5,271,919.85, respectively; and duly, properly and correctly reflected in such income tax returns the true and correct amount of its individual federal income tax liability due the United States on such taxable income, which federal tax liability the plaintiff duly, correctly and properly accrued on its books during each taxable year, all in accordance with sound and generally accepted accounting principles.

4. During each of the said calendar years, WESTERN also duly, properly and correctly accrued on its books, and duly, properly and correctly reflected

in each of the income tax returns filed with the State of Alabama that portion of its federal income tax liability so due and accrued, which is allocable to, or which is in proportion to, the income derived by the plaintiff from sources within the State of Alabama, amounting to the sums of $393,392.63, $192,887.38 and $1,912,780,000, [1/] respectively.

5. In computing the amount of the taxable income upon which income tax was due and payable by WESTERN to the State of Alabama for each of said calendar years, WESTERN, except to the extent indicated below, duly and properly deducted the

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1/ The parties have agreed that the amount of the federal tax apportioned and deducted for the year 1966 was in error and that the amount claimed by plaintiff to be recoverable from the State for the year 1966 is to be reduced from $102,013.63 actually paid by plaintiff on April 19, 1968 upon the additional assessment for the year 1966 to the sum of $75,695.40.

correct prorata amount of the accrued federal income tax which is allocable to and connected with its income derived from sources within the State of Alabama.

6. During each of the taxable years in question, plaintiff was a wholly owned subsidiary of Diversa, Inc., a Delaware corporation; and in each of those years the plaintiff joined with its parent and other non-resident affiliated corporations, none of which did business in the State of Alabama, in filing consolidated United States income tax returns, pursuant to provisions of Section 1501, et seq. of the Federal Internal Revenue Code, and the Regulations thereunder. In connection with the filing of such consolidated returns WESTERN prepared and sent to its parent a federal income tax return, which in all material respects was identical with

the return it would have filed with the Internal Revenue Service had plaintiff reported its income on a separate individual return. WESTERN executed these federal joint consolidated returns, along with its parent and the other affiliated corporations, by executing and filing the various forms and documents required to be executed and filed by the members of an affiliated group under the provisions of the federal laws and regulations applicable thereto. The consolidated returns thus prepared and filed by plaintiff's parent with the Internal Revenue Service during each of the taxable years in question contained, as required by federal law, a copy of the individual and separate income tax returns of the parent and of all of its affiliated corporations, including the plaintiff.

7. Pursuant to an agreement by and between the plaintiff and its parent, the plaintiff was obligated to pay to its parent all amounts accrued on its books for federal income taxes, based upon plaintiff's individual liability for such taxes to the Internal Revenue Service, and the plaintiff did pay to its parent in each of the taxable years in question the amount of the federal income taxes which was so accrued and which was due and payable by the plaintiff to the United States for each of said calendar years.

8. The parent of plaintiff, and other corporations affiliated therewith, and which joined in the filing of the consolidated returns for each of the years in question, sustained certain losses during the taxable years in question. In computing the consolidated taxable income

of the group of corporations the losses of the parent and the other affiliated corporations were used to offset the taxable income of WESTERN set out in paragraph 3 above, as permitted by the provisions of Section 1501, et seq. of the Federal Internal Revenue Code. As a result, the consolidated returns covering Diversa, Inc. and its affiliated subsidiaries, including the plaintiff, showed a loss for each of the taxable years 1964, 1965 and 1966, and Diversa, Inc., as the common parent authorized to file the consolidated returns on behalf of itself and its subsidiaries, paid no federal income tax for those years.

9. The amounts received by the common paret from WESTERN covering its own liability for federal income taxes for each of said calendar years was distributed

by the parent among the loss corporations affiliated therewith and which joined in the filing of the consolidated income tax returns for those years.

10. In the year 1968, Diversa, Inc., the common parent of plaintiff, had substantial earnings in excess of one million dollars, and a tax liability in excess of a half million dollars. Under the carry-forward and carry-back provisions of the federal income tax laws and regulations (See, §172 of the Internal Revenue Code of 1954, as amended), if no consolidated returns were filed by Diversa, Inc. for the taxable years in question, Diversa would have been able to carry forward the losses sustained by it in the years 1964, 1965 and 1966, and apply such losses against its earnings in the year 1968, with the result that its taxable income

and the amount of taxes due thereon to the United States for that year would have been substantially reduced. Such loss carry-forward privilege was lost by Diversa, however, because of the filing of the consolidated returns for the years 1964, 1965 and 1966, in which Diversa applied its losses against the taxable earnings of the plaintiff.

By the same token WESTERN by joining in the consolidated returns lost its opportunity to carry-back any losses it might sustain in future years and apply them against its earnings during the taxable years in question, and to secure a refund of income taxes paid for those years.

11. In 1967, the State Department of Revenue made an audit of the income tax returns of WESTERN for each of the

calendar years in question, and disallowed as a deduction from plaintiff's net income, the prorata amount of the federal income taxes so accrued by WESTERN and which were allocable to and connected with the income of WESTERN derived from sources within the State of Alabama. The disallowance was made on the sole ground that "while the plaintiff accrued the amount of its federal taxes on its books and paid the same to its parent, the same was not in fact paid by the parent to the United States at the time of the filing of the consolidated returns for those taxable years.", according to the stipulation of the parties. According to the official explanation of the State Department of Revenue made at the time of the audit the disallowance resulted "according to Alabama Income Tax Reg. 402.2 and also per court

case of Southern Railway vs. State of Alabama 1945".[2/]

12. The disallowance of the federal income tax deductions resulted in an assessment against WESTERN of additional income taxes for the years 1964, 1965 and 1966 of $8,620.55, $24,664.36 and $95,639.98, respectively.

13. On April 19, 1968, plaintiff appealed from the assessments pursuant to the provisions of Section 140, Title 51 Code of Alabama 1940, Recompiled 1958, and on said date paid to the State of Alabama the amount of said assessments, together with interest thereon, as follows:

(a) The sum of $10,235.16, covering the assessment for the year 1964;

2/ This is some unreported Circuit Court case which has not been called to the Court's attention by either party and upon which apparently neither party relies.

(b) The sum of $27,773.10, covering the assessment for the year 1965; and

(c) The sum of $102,013.63, covering the assessment for the year 1966. By agreement the claim for this payment has been reduced to $75,695.49.

The Issue Presented.

The principle issue presented in this cause is whether the plaintiff was entitled to deduct the prorata amount of the federal income taxes accrued by it, on the basis of its separate income tax liability to the United States, in computing the amount of its taxable income in its tax returns to the State of Alabama for the taxable years in question; and whether the State Department of Revenue had the power and authority to disallow such deductions on the sole ground that

the plaintiff paid the amount of its federal income tax liability to its parent, instead of to the IRS, and joined with its parent in the filing of federal consolidated income tax returns for each of said calendar years, where the consolidated returns by offsetting certain losses incurred by the parent, and other corporations affiliated therewith, against the earnings of plaintiff showed a loss for the affiliated group as a whole, and no tax due.

Conclusions of Law.

The Court turns first to a consideration of the basic constitutional provisions which allow the deduction by corporations of federal income taxes in computing net income for state income tax purposes. These constitutional provisions are:

"CCXII

State tax on net income of corporations.--The legislature shall have power to levy and provide for the collection of taxes for state purposes on net income of corporations, from whatever source derived, for the calendar year 1963, or for any fiscal year beginning in the calendar year 1963, and each year thereafter, at a rate not exceeding five percent. However, all federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, provided that in the case of foreign corporations the amount of federal income tax deductible shall be in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the legislature may enact." (As proposed by Act 91, Laws, 1963, 2nd Spec. Sess., and adopted at the election of December 10, 1963.)(Und. added)

In considering the above quoted constitutional amendment, the Court must be guided by the well recognized Canon of Construction that is construing the Constitution the leading purpose should be to ascertain and effectuate the intent and

object designed to be accomplished (State vs. Birmingham Southern R. Co., 62 So. 87 182 Ala. 475; Railroad Commission of Ala. vs. Ala. Great Southern R. Co., 64 So. 13, 185 Ala. 354; Alexander vs. State, Ex. Rel. Colver, 150 So. 2d 204, 274 Ala. 441); that in construing the language of the Constitution, the words used, unless they are technical, are to be understood in their usual and ordinary sense (Hagan vs. Commissioners Court of Limestone County, 49 So. 417, 160 Ala. 544; ex parte Pepper 64 So. 112, 185 Ala. 284), and that where the intention of a constitutional provision is clearly expressed by its terms or by necessary implications therefrom, no resort to secondary rules is necessary to obtain its meaning. (State Docks Commission vs. State, Ex Rel. Cummings, 150 So. 345, 227 Ala. 414.)

In the light of these generally

accepted rules of construction, the Court is constrained to conclude that the question at bar is foreclosed against the State by the clear mandate of the constitutional amendment that all federal income taxes whether paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, and that in the case of foreign corporations the amount of the federal income taxes so deductible are limited only by the requirement that it be "in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the Legislature may enact."

What laws then did the Legislature of Alabama enact subsequent to December 10, 1963. Between December 10, 1963 and the year 1969, the Legislature enacted no

law dealing with the deductibility of federal income taxes by corporations, domestic or foreign. The only Legislative Act on the subject in effect on the date of the passage of the Constitutional amendment was Section 402, Title 51, Code of Alabama 1940, as amended by Act No. 107, passed on May 8, 1963. This Act expressly denied to corporations the right to deduct federal income taxes in computing net income subject to Alabama income tax laws.

The State points to Act 104, Acts of Alabama, Second Special Session 1963, page 289. This Act did indeed implement the Constitutional Amendment, but it simply amended Section 398, Title 51 of the Code, dealing with the "imposition of taxes", and increased the state tax from 3% to 5%. Act 104 does not deal with de-deductions of any kind. It was not until

Act No. 24, Laws 1969, First Special Session, that the Alabama Legislature amended Section 402(1), Title 51, of the Code so as to remove the prohibition of the deduction of federal income taxes created by Act 107. Act No. 24 expressly allows the deduction of federal taxes in computing the net income of corporations:

> "(3) Taxes paid or accrued within the taxable year (a) imposed by the authority of the United States,...in the case of a foreign corporation taxes paid or accrued within a taxable year...; the amount of federal income tax which shall be deductible by such foreign corporation shall be determined by the ratio that the net income...of the corporation on business done within Alabama bears to its net income... from business done both within and without the State of Alabama."

Accordingly, this statute may be said to be the first enactment by the Legislature of Alabama to implement the deduction provisions of the Constitutional

Amendment above set out. While this amendment to Section 402(1), Title 51 of the Code does not control the taxable years at issue, it is significant to note the legislative intent that all deductions for taxes are to be made on the basis of either actual payment or accrual, and that the apportionment of federal income taxes in the case of foreign corporations is to be determined simply by the ratio which the amount of business done in Alabama bears to the business done within and outside of Alabama.

The State also points to Regulation 402.2 promulgated by the State Department of Revenue on November 16, 1960, (initially promulgated in 1962), but this regulation does not support the State's contention here. On the contrary, it supports the position of the plaintiff.[3/] This

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regulation, in pertinent part, provides:

> "Where a corporation operates both within and without Alabama..., the amount of federal income tax allocated to Alabama should be determined by the ratio that the net income from sources within Alabama bears to the total net income from all sources as shown by the Federal income tax return. The Federal income tax to be apportioned in this manner is the tax accrued as shown by the final federal income and excess profits tax return of taxpayer..."

The consolidated returns filed by the parent of plaintiff in its behalf and in behalf of the other affiliated

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3/ The plaintiff contends that this regulation adopted in 1960 is geared to the Statute, Section 402, and not to the Constitutional Amendment adopted in 1963, and that the latter part of this regulation dealing with the deductibility of federal income taxes could not have been in effect in 1964, 1965 and 1966, during which years Section 402, as amended by Act 107, expressly denied such deduction. While there is a great deal of merit to plaintiff's contention, it is unnecessary for the Court to decide this question, since there is nothing in this regulation which deprives plaintiff of the claimed deductions.

corporations constitutes under the federal tax laws the final federal income tax and excess profits tax return of the parent as well as of all of its affiliated corporations. See, Federal Regulations 1.1502-12a - 15a - 18a - 31a (a) 16A. Pursuant to the federal law and these regulations incident to the filing of consolidated returns, each of the corporations joining in a consolidated return is required to prepare and file as part thereof its own separate and individual tax return.

The consolidated returns prepared and filed by Diversa, Inc., with the Internal Revenue Service during each of the taxable years in question contained, as required by these federal regulations, a copy of each of the individual and separate income tax returns not only of the

parent, but of each of its affiliated corporations, including the plaintiff.

The consolidated returns for each of the taxable years in question duly and properly reflected the tax liability of the plaintiff to the United States Government for each of the taxable years in question, as if it filed separate income tax returns, which tax liability was consistent with the amount of the tax liability plaintiff accrued on its books, and which was reflected in its income tax returns filed with the State of Alabama for these taxable years.

The Court concludes, therefore, that plaintiff fully complied with the provisions of Regulation 402 of the State Department of Revenue, assuming the same to be applicable.

The Question of Payment of the Accrued Taxes.

The State next argues that the deductions should be disallowed because the plaintiff did not pay the amount of the accrued federal taxes to the IRS, but instead paid the same to its parent, but neither the constitutional amendment, nor any statute of the State, nor any regulation of the State Department of Revenue in effect during the taxable years in question requires such payment. On the contrary, the constitutional amendment speaks alternatively to "all federal income taxes paid or accrued." So does the implementing statute, Section 402(1) of 1969. So, also, does Section 402 as it existed prior to 1963.

It is significant also to note here that Regulation 402.2 of the State Department of Revenue promulgated on November 16, 1960, and claimed by the State to be in effect during the taxable years

in question, and as the very basis upon which the additional additional assessments are grounded, eliminates the alternative "paid" altogether and speaks solely to "the tax accrued as shown by the final federal income and excess profits tax return of the taxpayer..."

Furthermore, the term "paid" is defined by Section 376(k), Title 51, Code of Alabama 1940, as:

> "The term 'paid' for the purpose of deduction and credit hereinafter provided for with respect to income tax means paid or accrued or paid or incurred, and the term 'paid or incurred' and 'paid or accrued', shall be construed according to the method of accounting on the basis on which the net income is computed under this chapter."

The State's contention that federal taxes to be deductible for state income taxes must be both accrued and paid is not only contrary to the constitutional, statutory and regulatory provisions, but

also to the adjudicated decisions of both State and Federal Courts.[4/]

The United States Supreme Court adopted the "all events test" in United States vs. Anderson, 269, U.S. 422, 70 L. Ed. 347, 46 S. Ct. 131, to determine the deductibility of taxes by an accrual basis taxpayer. According to this test, taxes are deductible by a taxpayer on an accrual basis if all events fixing the fact of, and the amount of, the taxpayer's liability have transpired, though the tax is actually not paid. This is true even

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4/ The First National Bank vs. State, 29 So. 2d 673; State vs. Yellow Pine Lumber Co., 83 So. 2d 317; Clark, et al vs. State, 51 So. 2d 882; Mertens Law of Federal Income Taxation, Vol. 5, Sections 27.52, 27.55 and 27.57; Mertens Law of Federal Income Taxation, Vol. 2, Sections 12.08, 12.76 and 12.91; Section 376(k), 383 and 384 Title 51, Code of Alabama, 1940, Regulation 383.3 of the State Department of Revenue.

though the exact amount may not have been precisely ascertained by the taxpayer at the close of the year. Frost Lumber Industries vs. Commissioner of Internal Revenue, 128 F.2d 693 (Fifth Circuit); Santa Fe Drilling Co. vs. Riddell, 217 F. Supp. 630.

In Yellow Pine Lumber Company, the Supreme Court of Alabama followed this rationale, holding:

> "It is well settled that where accounts are kept and tax returns made on the accrual basis as distinguished from the cash basis, income is accrued to and allocable to the year in which the right to receive the income becomes fixed, even though the income is not actually received until a subsequent year."

By the same token, where accounts are kept and tax returns made on the accrual basis as distinguished from the cash basis the same principles apply to the accrual of taxes for tax purposes.

Clarke vs. State; Santa Fe Drilling Co. vs. Riddell, supra.

Accordingly, the Court finds and holds that all events fixing the fact of and the amount of the plaintiff's own and separate income tax liability to the United States have transpired though not paid, during each of the taxable years in question; that the plaintiff duly, properly and correctly accrued on its books, and duly, properly, and correctly reflected in each of its income tax returns filed with the State of Alabama during each of said taxable years its accrued federal income tax liability due by it to the United States on its taxable income earned within and without the State of Alabama; and that the plaintiff duly, properly and correctly apportioned the prorata amount of the federal income tax so accrued during each of the taxable years in ques-

tion, which is allocable to and connected with the income of plaintiff derived from sources within the State of Alabama, except the allocation made during the year 1966, as hereinabove set out, which has now been corrected and adjusted by agreement of the parties.

The Effect of the Consolidated Returns

Finally, the Court turns to consider the question of the effect of the joinder by the plaintiff in the filing of the federal consolidated income tax returns during the taxable years in question.

The State contends that since the earnings of WESTERN were offset by the losses of its parent and other affiliated corporations, and the consolidated group showed a loss and owed no tax, WESTERN was not entitled to a deduction for State

income tax purposes of any portion of the federal tax allocable to its earnings derived from sources in Alabama. The Court disagrees, and accepts as sound the argument of plaintiff that it would be highly unfair and unjust that the State resort to the federal consolidated returns for the purpose of defeating the plaintiff's federal tax deduction on the theory that the consolidated group of corporations showed an operating loss upon which no federal tax was due, and at the same time, divorce the plaintff from the consolidated group for the purpose of determining and taxing its earnings on a separate basis.

The concept of filing consolidated returns for affiliated corporations is peculiar to federal income tax law and is completely foreign to the Alabama State Income Tax System. The income of a foreign

corporation doing business in Alabama for State tax purposes must be determined upon its own separate operations; and such income may not be by losses or increased by profits of affiliated corporations, especially those doing business outside of Alabama. In like manner, the allowable deduction to a corporation doing business in Alabama for federal income taxes must also be determined upon an individual basis, that is, upon the extent of the corporation's separate tax liability to the United States on its own income, properly apportioned, as required by the Alabama Constitution, unaffected by any losses or profits of its parent or other affiliated corporations. 5/ The right and

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5/ Even the losses sustained outside Alabama by a domesticated foreign corporation itself have been held by the Alabama

obligation of the plaintiff as a separate taxpayer to accrue the amount of federal taxes during the taxable years in question is to be determined by federal laws. 6/ The federal decisions are clear to the view that corporations joining in the filing of consolidated returns continue to be separate taxable units as to their respective taxable income and are the only "taxpayers", within the meaning of the federal income tax statutes. The consolidated group is a mere computing

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Court of Appeals in State Dept. of Revenue vs. Fuqua, 261 So. 2d 410, not to affect the deductibility of the amount of federal taxes which "would have been paid" by the corporation on its earnings derived from sources in Alabama.

6/ Sloss vs. State of Alabama, 89 So. 2d 174.

7/ Helvering vs. Morgan's, 79 L.Ed. 232, 293 U.S. 121; Wolford Realty Co. vs. Rose, 76 L.Ed. 1128, 286 U.S. 319.

unit upon whom no tax is levied by either state or federal law.

The State's reliance upon Trunkline vs. Collector of Revenue, 182 So. 2d 674 (La.) is misplaced for two reasons. In the first place Trunkline dealt with a Louisiana regulation which speaks specifically to the results of the joinder by a Louisiana domesticated corporation in the filing of a federal consolidated return, and which expressly disallows the deduction of federal income taxes where the consolidated return shows no federal tax liability. There is no such law or regulation here involved.

Secondly, the Louisiana Court held that deductions for income tax purposes are of legislative grace and that Louisiana elected not to grant deductions under the circumstances there involved. 'In Alabama, on the other hand, the allow-

ance of deductions of federal income taxes is no longer subject to legislative grace. The Constitutional Amendment adopted by the people in December 1963, abrogated Act No. 107, and in the strongest terms possible adopted the policy that federal income taxes "shall always be deductible". Thus, in Alabama, unlike in Louisiana, it is no longer within the power of the Legislature to deny such deductions. And it is certainly not within the power of the State Department of Revenue to do so.

This Court has the highest respect for the decision of the Honorable Eugene W. Carter in the Standard Oil Company case. However, Judge Carter adopted a formula for the apportionment of federal taxes among the profit corporations of a consolidated group, a situation which does not exist here. To the extent that

such decision may be said to apply to the facts here involved, this Court, with all due deference, declines to follow it.

On the contrary, the Decision of the Supreme Court of Kansas in the case of Cities Service Gas Co. vs. McDonald, 466 P.2d 277 is squarely in point, its logic and reasoning most persuasive, and it fully supports the position and claims of the plaintiff here.

Accordingly, the Court finds and holds that (1) the plaintiff properly and correctly accrued on its books the amount of the federal income taxes due by it to the federal government as a separate taxpayer; (2) that plaintiff was entitled to deduct the prorata portion thereof in determining its income for Alabama income tax purposes; (3) that the action of the State Department of Revenue in denying such deduction is inconsistent with and violates

the provisions of the Constitutional mandate of the State of Alabama, as above set out; (4) that the assessments made against the plaintiff for the taxable years in question are invalid and void, and (5) that the plaintiff is entitled to recover the amounts paid to the State of Alabama on account of such invalid assessments, together with interest thereon, from April 19, 1968.

Judgment

It is, therefore, ordered, adjudged and decreed that the plaintiff have and recover of the defendant as follows:

(a) The sum of $10,235.16, together with interest thereon at the rate of 6% per annum, from April 19, 1968, amounting to the sum of $3,851.00 covering payment upon the invalid assessment for the year 1964;

(b) The sum of $27,773.10, to-

gether with interest thereon at the rate of 6% per annum, from April 19, 1968, amounting to the sum of $10,387.00 covering payment upon the invalid assessment for the year 1965;

(c) The sum of $75,695.49, together with interest thereon at the rate of 6% per annum, from April 19, 1968, amounting to the sum of $28,310.00, covering payment upon the invalid assessment for the year 1966; or

(d) The total of the sums set out in (a), (b) and (c) above amounting in the aggregate to the sum of $156,251.75.

DONE and ORDERED at Birmingham, Alabama on this the 16th day of July, 1974.

/s/ William C. Barber
Circuit Judge

Supreme Court, U. S.
FILED
FEB 25 1976
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No. 75 - 1061

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

MOTION TO DISMISS AND MOTION TO AFFIRM

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No. _____

WESTERN GRAIN COMPANY, a corporation,

Appellant

v.

STATE OF ALABAMA,

Appellee

ON APPEAL FROM THE COURT OF CIVIL APPEALS AND THE SUPREME COURT OF ALABAMA

MOTION TO DISMISS AND MOTION TO AFFIRM

Appellee pursuant to Rule 16, Revised Rules of the Supreme Court of the United States (U.S. Sup. Ct. Rule 16, 28 U.S.C.A., 1975 Pocket Part), moves that the Final Judgment and Decree of the Court of Civil Appeals of Alabama Reported in 318 So.2d 719 (Appendix A(2), Jurisdictional Statement of the Appellant); the Ruling Application For Rehearing, the Court of Civil Appeals of Alabama (Appendix A(4), Jurisdictional Statement of the Appellant); and the Denial of the Writ of Certiorari by the Supreme Court of Alabama (Appendix B(1), Jurisdictional

Statement) be affirmed on the following grounds: **first**, the jurisdictional statement of the Appellant does not present a federal question or, at the very least, it does not present a substantial federal question; **second**, the Supreme Court of Alabama denied certiorari to the Alabama Court of Civil Appeals (Jurisdictional Statement, Appendix B(1)) and the constitutional question was presented to the Supreme Court of Alabama in the Petition for Certiorari; **third**, the Court of Civil Appeals found adequate non federal basis on which to determine the issue and this fact was recognized in the Alabama Supreme Court's denial of Certiorari; (See Appendix A2 and Appendix B(1) Juris Statement.) **fourth**, the Court of Civil Appeals of Alabama in the case of **Standard Oil of Kentucky v. State**, 294 Ala. 3, 313 So.2d 532, decided a case of similar import; the **Standard Oil Case** was cited as authority in **State v. Western Grain**, supra, (Appendix A(2) p. 2, Jurisdictional Statement); the Petition for Certiorari was likewise denied and **fifth**, the questions presented are so unsubstantial that no further argument is warranted.

In the alternative the State moves that the Appeal by Western Grain (Jurisdictional Statement, Appendix C(1)) be dismissed and assigns the same grounds as were assigned on motion to affirm, preceding.

The questions raised in the lower court were of local concern in that they dealt primarily with a state of Alabama Constitutional amendment, a statute of the state of Alabama and a regulation of the Department of Revenue, State of Alabama which are set out herein, infra, and the construction of that amendment, that statute and that regulation by the courts of the State of Alabama as they applied to a corporation doing business in Alabama.

OPINIONS BELOW

This case is an appeal from a judgment of the Court of Civil Appeals of Alabama rendered on June 11, 1975 (Jurisdictional Statement, Appendix A(2) and the denial of a Petition for Certiorari by the Supreme Court of Alabama entered on October 30, 1975 (Jurisdictional Statement, Appendix B(1)). The Alabama Court of Civil Appeals had construed the identical questions in the case of **Standard Oil of Kentucky v. State**, supra, therefore, the questions were not of first impression in the Alabama Courts.

JURISDICTION

It will be noted in the statement as to jurisdiction in the Jurisdictional Statement of the Appellant, p. 2, thereof, the Appellant draws into its appeal under 28 U.S.C., Section 1257 (2), Regulation 402.2, Income Tax Laws, State Department of Revenue, State of Alabama, 1952, (Appendix D of Jurisdictional Statement and set out herein, infra under the heading Constitutional Amendment, Statutes and Regulations); and Amendment CCXII, Constitution of Alabama, 1901, Act 91, Laws 1963, Second Special Session of Legislature of Alabama (Also set out herein, infra). Counsel for Appellant avers that the constitutional amendment and the regulation as construed and applied to the Appellant, a foreign corporation, are "so arbitrary, unreasonable and discriminatory that it is (sic) repugnant to the Constitution and laws of the United States".

The Court of Civil appeals of Alabama deals with this exact question of discrimination in the opinion rendered in this case (Jurisdictional Statement of Appellant, Appendix A(2), pp. 10-12.) The language of the Court by Presiding Judge Wright is as follows:

"Western contends that the application of the amendment and regulations in such manner is discriminatory as to corporations who choose to join in consolidated returns and is constitutionally impermissible.

We are unable to perceive any discrimination. Every foreign corporation earning income in Alabama is taxed the same--upon taxable income after deduction of federal income taxes paid or accrued. The decision to join in a consolidated return for federal income taxes or file a separate return is that of the taxpayer. Filing a consolidated return is a privilege and results in a consolidated tax liability. 26 U.S.C.A. §1501. If it benefits in relief from federal taxes it may cost in the amount of deductions permitted by the State. Such results in a penalty by choice of the taxpayer. It is not discrimination by the State. We are cited to no case in point to the contrary."

The emphasis in the opinion of the Court of Appeals in the instant case is on the fact that the law, Constitutional Amendment CCXII, supra, as "construed in the light of statutes and regulations relating to the same subject, i.e., Title 51, Section 402(13), Regulation 402, deductions of federal income taxes is non discriminatory as applied to the Appellant. In the case of **Kentucky Standard Oil**, supra, the court applied the constitutional amendment, the statute and the regulation. In regard to Kentucky Standard Oil (Kyso) the Court by Judge Wright stated, in part:

"This court in the Kyso case held that amendment CCXII to the Alabama Constitution is to be construed in light of statutes and regulations relating to the same subject, i.e., Title 52, (Sic, 51) Sec. 402(13), Regulation 402.2, deductions of federal income taxes. We said,

'. . . .We interpret the phrase "paid or accrued" to mean the amount paid from the parent to the IRA. . .

To this court no federal income taxes were actually "paid" or "accrued" by Kyso by the filing of an accounting statement with Socal.'

We follow our construction of Amendment CCXII in **Kyso** in this case. Through Western, in bookkeeping terms, accrued on its books a calculated federal income tax which it would have been due to pay had it not chosen to use the consolidated return, it, in fact, did not pay such sum to the Internal Revenue Service nor did it incur liability for such payment. Such tax in terms of actual liability to the taxing authority did not accrue. The severable liability of the members of the affiliated group extends only to the tax due under the consolidated return. **IRS Reg.** Sec. 6 (a) 1.1502.

Appellee quotes from Vol. 8A, Mertens Law of Federal Income Taxation, Sec. 46.77, as follows:

" 'In computing separate taxable income of a member for use in the computation of consolidated taxable income under Regulation 1.1502-11 the starting point is a computation in accordance with the provisions for determining taxable income of separate corporations, with a number of specified exceptions.'

This quotation was given in support of the proposition that each member of the group consolidated for report of income and payment of taxes is the taxpayer and the amount of tax computed on its own taxable income and shown as accrued thereon is tax imposed upon it by the United States. We cannot agree such is, in fact, the case. Of course, the beginning point of a consolidated return is the sum of the taxable income of each member. Such is the case in the consolidated or joint return of a husband and wife. The taxable income of a group cannot be computed without first determining the taxable income of each member thereof. Each member of the group is a reporting unit insofar as its taxable income is determined, and all are severally liable for the tax due under the consolidated return, but there is no liability incurred, paid or accrued by a member of the group

according to its separate taxable income. Removal of such liability is one of several benefits derived from joining in a consolidated return.

We interpret the phrase 'paid or accrued' contained in the constitutional amendment to mean actually paid or a liability to pay. When filing a consolidated return the tax which would have been paid or accrued by a member had it not joined the group is not determined nor is it necessary to be determined, except as required by the agreement between the parent and the members of the group. No such liability is ever incurred or accrued insofar as the taxing authority is concerned."

CASES WHICH ARE CONCERNED WITH THE MATTER AT ISSUE

There appear to be only four cases which have come to grips with the exact question extant herein: that is, how will each state for state income tax purposes apportion the federal income tax of a corporation operating in the state where the corporation joins with its parent corporation in filing a consolidated return with the I.R.S.

One of the four cases is the one presently before this bar; the second is that of **Standard Oil of Kentucky v. State of Alabama,** supra; the third is **Trunkline Gas Company v. Collector of Revenue,** 182 So.2d 674, cert. denied 248 La. 1101, 184 So.2d 25; and the fourth is **Cities Service Gas Company v. McDonald,** 204 Kans. 705, 466 P.2d 277. Each of these cases was decided by an appellate court in their state of origin and in each case state laws were construed and three were determined by the construction of a state regulation promulgated by the state to implement the state statute. The absence of a regulation in Kansas was the key to the Court's opinion in **Cities Service Gas Company** case, supra.

THE CASES CITED BY THE APPELLANT IN ATTEMPT TO SUSTAIN JURISDICTION (JURISDICTIONAL STATEMENT, P. 7)

Counsel for Appellee has reviewed the cases cited by the Appellant in his attempt to sustain jurisdiction of the Supreme Court of the United States. None of the ten cases cited and discussed following are concerned with the filing of consolidated income tax returns and some of the cases are not even concerned with the subject of income taxation. They are not pertinent to the issue or issues at hand.

A cursory statement concerning the scope of each of the ten cases follows:

Hans Ree's Sons, Inc. v. State of North Carolina, 283 U.S. 123, 75 L.Ed. 879. The case involved the construction of a North Carolina Statute which took a far greater percentage of the income of the corporate taxpayer than was warranted by the business done by the taxpayer in the state.

General Motors Corporation v. District of Columbia, 380 U.S. 553, 14 L.Ed.2d 68, 85 S.Ct. 1156, involved the levy and collection of a District of Columbia Income and Franchise Tax. The taxing authorities violated the statutory authority vested in them by taxing the income of the corporation and not allocating any of the income to sources outside the District of Columbia.

Ivanhoe Irrig. Dist. v. McCracken, 357, U.S. 275, 2 L.Ed.2d 1313, 78 S.Ct. 1174, was not concerned with consolidated return; not even concerned with income taxation and not pertinent to the issue.

NAACP v. Alabama, 377 U.S. 288, 12 L.Ed.2d 325, 84 S.Ct. 1302, has no bearing on issues in the instant case. The question did not involve taxation but was concerned with whether the corporation could operate in Alabama.

Palmore v. U.S., 93 S.Ct. 1670, 411 U.S. 389, 36 L.Ed. 342, was a criminal case arising in California and having no bearing on the current controversy.

Durley v. Mayo, 351 U.S. 277, 100 L.Ed. 1178, 76 So.Ct. 806. This case was dismissed by the Supreme Court of the U.S.; however, it was a criminal case having little bearing on the questions at issue. The case was decided by the Florida Court on adequate state grounds.

WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117, 21 L.Ed.2d 242, 89 S.Ct. 286. This was an obvious flagrant violation of the rights of a non profit foreign corporation in New Jersey compared with the rights accorded similarly situated domestic corporations in New Jersey. Foreign corporation was denied exemption from ad valorem taxes which exemption was granted to domestic corporations. Has no bearing on the questions at issue in the instant case.

Carl M. Austin v. New Hampshire, 43 L.Ed.2d 530. Non residents of New Hampshire paid an individual income tax, a so-called commuter income tax. Residents of New Hampshire did not have a like tax levied on them. Thus a flagrant discrimination was involved. But the case has no relation to immediate issue before the bar.

Allied Stores of Ohio v. Bowers, 358 U.S. 522, 3 L.Ed.2d 480, 79 S.Ct. 437. The domestic Ohio corporation was taxed on the storage of goods in warehouse. Non resident did not have to pay a like tax on storage of goods for storage only. The Supreme Court of the U.S. stated, in part, as follows:

> ". . .The States have a very wide discretion in the laying of their taxes. When dealing with their proper domestic concerns, and not trenching upon the prerogatives of the National Government or violating the guaranties of the Federal Constitution, the States have the attribute of sovereign powers in devising their fiscal systems to ensure revenue and foster their local interests. Of course, the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation."

The statement quoted above is a firm statement of what the state of Alabama has done in the instant case. It has applied a state constitutional provision, a state statute and regulations equally to taxpayers in a class and has in no way discriminated against the taxpayer, Western Grain.

Wheeling Steel Corp. v. Glander, 337 U.S. 562, 93 L.Ed. 1544, Anno. 100 L.Ed. 1200. Foreign corporation operating in Ohio is entitled to the same rights in regard to ad valorem taxation as a domestic corporation.

CONSTITUTIONAL AMENDMENT, STATUTES AND REGULATIONS

AMENDMENT CCXII CONSTITUTION OF ALABAMA, 1901, (SEE VOLUME 1, CODE OF ALABAMA, RECOMPILED 1958, 1973 POCKET PARTS P. 201) provided as follows:

> "The legislature shall have power to levy and provide for the collection of taxes for state purposes on net income of corporations, from whatever source derived, for the calendar year 1963, or for any fiscal year beginning in the calendar year 1963, and each year thereafter at a rate not exceeding five percent. However, all federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, provided that in the case of foreign corporations

the amount of federal income tax deductible shall be in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the legislature may enact."

Act 107, Legislature of Alabama, 1963, Regular Session, P. 289, Acts of Alabama, 1963, Volume 1 Which Further Amended Section 402, Title 51, Code of Alabama 1940, Recompiled 1958, provided, in part, as follows:

"Section 1. Code of Alabama 1940, Title 51, Section 402, as amended, is amended further to read as follows:

'Section 402. In computing the net income of domestic corporations doing business in this state subject to the tax imposed by section 398 of this title, there shall be allowed as deductions: * * *

(3) Taxes paid or accrued within the taxable year (a) imposed by the authority of the United States, except income taxes, * * * in the case of a non-resident individual or foreign corporation taxes paid or accrued within the State of Alabama or any county, school district, municipality or any other taxing subdivision of the State of Alabama excluding the income taxes levied and imposed under this title, plus the proportion of tax imposed by other authorities above mentioned which the amount of gross income from sources within the State of Alabama bears to the amount of gross income from all sources within and without the State of Alabama.'

* * * * * *

'(13) In the case of foreign corporations doing business in this state the deductions allowed by this section shall only be allowed if and to the extent that they are connected with income arising from sources within the State of Alabama, and the proper apportionment and allocation of deductions with respect to the sources of income within and without the State of Alabama shall be determined under the rules and regulations prescribed

by the department of revenue, provided that in the case of corporations doing a business partly within and partly without the state where revenue is apportioned or allocated to Alabama the expense in connection with such apportioned or allocated revenue shall be likewise apportioned or allocated to the state, for the purposes of deductions under this title, or the ratio that company expenses in Alabama bear to the company revenues in Alabama.'

Section 2. The provisions of this Act shall apply to income taxes due for taxable years beginning after December 31, 1962." (Emphasis supplied.)

REGULATION 402.2, INCOME TAX LAWS AND REGULATIONS, STATE OF ALABAMA, 1952, p. 111, provided, in part, as follows:

"A foreign corporation doing business in Alabama is entitled to the same deductions allowed a domestic corporation, but only to the extent that they are connected with income arising from sources within the State. A corporation having income from multi-state operations may apportion its income in accordance with Reg. 398.2, in which case allowable deductions must also be apportioned in the same manner.

* * * * *The amount of Federal income tax allocated to Alabama should be determined by the ratio that the net income from sources within Alabama bears to the total net income from all sources as shown by the Federal income tax return. The Federal income tax to be apportioned in this manner is the tax accrued as shown by the final Federal income and excess profits tax return of the taxpayer and reduced by any refund allowed and given during the tax year under the Federal statute. Such refund need not be included in income when apportionment is made in this manner." (Emphasis supplied.)

QUESTIONS PRESENTED TO THE SUPREME COURT OF THE UNITED STATES

1. Is the decision of the Court of Civil Appeals (Jurisdictional Statement Appendix A(2)) a valid decision in that it is not repugnant to the constitutional mandates of the U.S. or of Alabama as applied to the Appellant in the instant case?

2. Is the Constitutional Amendment, Amendment CCXII, Consitution of Alabama, 1901, supra, fair and equitable as applied to all corporations in the same class as the Appellant?

3. Is the statute, Section 402(13), Title 51, Code of Alabama 1940, Recompiled 1958, supra, wherein it provides in the case of foreign corporations for apportionment of tax to Alabama and deductions from tax in accordance with income produced in Alabama in proportion to income produced everywhere fair and equitable as applied to the Appellant?

4. Is the regulation, Regulation 402.2, Income Tax Laws and Regulations, Department of Revenue, 1952 (Reissued verbatim in 1960 and amended in 1971), supra, as an implementation to the statute, Section 402, supra, fair and equitable as applied to the Appellant?

5. Did the Court of Civil Appeals of Alabama in its opinion (Jurisdictional Statement Appendix A(2)) and did the Supreme Court of Alabama in its denial of certiorari (Jurisdictional Statement Appendix B(1)) fairly construe the application of the Constitutional Amendment, CCXII, supra, the statute, Section 402, supra, and the regulation, 402.2, supra, to the facts in the instant case and render an opinion which was just and equitable to the Appellant?

6. Are the issues under consideration of local state import only and have they been properly decided by the state courts?

7. Finally, is the opinion of the Court of Civil Appeals of Alabama (Jurisdictional Statement, Appendix A(2)) denial of certiorari by the Supreme Court of Alabama (Jurisdictional Statement, Appendix B(1)) so arbitrary, unreasonable and capricious when applied to the Appellant that the decisions are repugnant to the Federal Constitution so that a federal question is involved; and if so, is the question of such scope that it is substantial enough to warrant the Supreme Court of the United States assuming jurisdiction of the instant case?

STATEMENT OF THE CASE

This case arose as an appeal (R. pp. 1-7) in the Jefferson Circuit Court from an income tax assessment by the Department of Revenue against the Appellant, Western Grain. The assessments were for the years 1964, 1965 and 1966 entered on March 21, 1968 in the amounts of $10,180.87 for 1964 (R. pp. 205-207), $27,626.34 for 1965 (R. pp. 181-183) and $101,472.98 for 1966 (R. pp. 157-158). The pleadings were properly perfected and tried before the Jefferson Circuit Court before the Honorable William C. Barber on May 2, 1974. It was agreed orally at the hearing that the issues in the appeals for the three years were the same and that evidence adduced would be applicable for all three years. Subsequent to the appeal of the case by the State of Alabama to the Supreme Court of Alabama on motion by the Appellee, the three cases were consolidated by order of the Clerk of the Supreme Court (R. p. 283) so that one brief, one oral argument and one opinion would be sufficient to dispose of all three cases. The Court was properly organized (R. p. 1).

At the trial, the Appellant presented one witness, Mr. James W. Robertson (R. pp. 50-103) and the state presented two

witnesses, Mr. V. S. McElvy (R. pp. 104-122) and Mr. Gerald Martin (R. pp. 125-127). After the hearing the matter was submitted to the Court on the statement of counsel which were not recorded, the testimony of the witnesses, the exhibits, Joint Exhibit 1, (R. pp. 133-212), which was a stipulation agreed upon by the parties and a record of proceedings before the State Department of Revenue which led to the final assessments and to the appeal by the Appellant to the Jefferson Circuit Court. Further, the submission for final decree was based on Plaintiff's Exhibits 1, 2, 3, 4 and 5 (R. pp. 213-262). The Court after due consideration determined that the Appellant, Western Grain, was correct and a final decree (R. pp. 264-281) (Appendix A(1), Jurisdictional Statement) was entered in favor of Western Grain. From this adverse decree, the State of Alabama, Appellee, prosecuted its appeal to the Supreme Court of Alabama (R. pp. 282-283). The appeal was to the Supreme Court of Alabama; however, it was determined that the appeal should not be before the Supreme Court but before the Court of Civil Appeals and, therefore, by order of the Clerk of the Supreme Court dated January 27, 1975, the cases were transferred from the Supreme Court to the Court of Civil Appeals and assigned new numbers as follows: Civ. 525, 525A, 525B. Counsel for the State of Alabama found it necessary to request additional time for filing the State's brief and the Court of Civil Appeals by order of January 29, 1975 granted an extension to and include February 18, 1975.

After oral argument by counsel on April 21, 1975, the Alabama Court of Civil Appeals by Presiding Judge Wright gave an opinion (Jurisdictional Statement, Appendix A(2)) reversing the decree of the Jefferson Circuit Court (Jurisdictional Statement, Appendix A(1)). Western Grain petitioned the Court of Civil Appeals for rehearing which petition was denied (Jurisdictional Statement, App. A(2)).

Western Grain thereafter applied to the Supreme Court of Alabama for certiorari which petition was denied (Jurisdictional Statement B(1)). Subsequently, Western Grain petitioned the Supreme Court of Alabama for rehearing and this petition was overruled (Jurisdictional Statement, Appendix B(2)).

From the adverse ruling of the Court of Civil Appeals and the denial of Certiorari by the Supreme Court of Alabama, Western Grain appealed to this Honorable Court (Jurisdictional Statement, Appendix C(1)).

STATEMENT OF THE FACTS

As enumerated in the statement of the case preceding, final assessments were entered against the Appellee, Western Grain, for income tax for the years 1964, 1965 and 1966. They were entered on March 21, 1968 in the amount of $101,472.98 for the year 1966 (R. pp. 157-158), $27,626.34 for the year 1965 (R. pp. 181-183), $10,180.87 for the year 1964 (R. pp. 205-207). The taxes which were in dispute were based on income of Western Grain. The corporation is organized under the laws of the State of Delaware but it has its principal place of business in Birmingham, Alabama. It is engaged in the manufacture and milling of grain products which are marketed under the trade name, Jim Dandy.

The Appellant reported taxable income for 1964 in the amount of $691,417.81 and paid tax to the State of Alabama in the amount of $34,570.89 after taking a federal income tax deduction of $172,410.92 (R. p. 221). For 1965 the Appellant

reported net taxable income of $1,069,206.35 and paid Alabama income tax in the amount of $28,815.95 after taking a federal income tax deduction of $492,887.38 (R. p. 236). In 1966 the Appellant reported net taxable income of $3,019,790.78 and paid Alabama income tax in the amount of $55,350.54 after taking a federal income tax deduction of $1,912,780.00 (R. p. 246).

The amount of federal income tax deducted by the Appellant was the amount it would have paid to the federal government if it had filed a return directly with the I.R.S. rather than filing an accounting statement with Diversa for Diversa to file a consolidated return with the I.R.S.

The Appellant was operating on the accrual method of accounting and had during the years in question accrued federal income tax on their books; however, it was incumbent upon them to pay this sum to the parent, Diversa, under the concept of affiliated corporations paying the tax to the parent and the parent filing a consolidated return with the I.R.S. (R. p. 135) (See opinion of Court of Civil Appeals, Jurisdictional Statement, Appendix A(2)).

The State of Alabama disallowed the claimed federal income tax deductions for 1964, 1965 and 1966 and recomputed the amount to be deducted based on the actual amount the parent Diversa paid I.R.S. (R. p. 136).

In fact, Diversa did not pay any tax to I.R.S. (R. p. 135, line 18) so the entire sums claimed by the Appellant, Western Grain, were disallowed. That is, since Diversa after consolidating the gain subsidiaries with the loss subsidiaries did not in fact pay any tax to the federal government, the State disallowed the claim of $172,410.92 for 1964, (R. p. 135) the claim of

$492,887.38 (R. p. 135) for 1965 and the claim of $1,912,780.00 for 1966 (R. p. 135). (The worksheets showing the computations have been introduced into the record as Appellant's exhibits.)

The result of disallowance resulted in additional taxes being due for 1964, 1965 and 1966. Final assessments were entered as stated above for each of the years; i.e., $10,180.87 for 1964 (R. pp. 205-207); $27,626.34 for 1965 (R. pp. 181-183); and $101,472.98 for 1966 (R. pp. 157-519).

From these final assessments, the Appellant prosecuted its appeal to the Jefferson County Circuit Court. Judge Barber of the Jefferson Circuit rendered a decree in favor of the Appellant, Western Grain (Jurisdictional Statement, Appendix A(1)).

The appeal by the State and the reversal by the Court of Civil Appeals and subsequent proceedings in the state courts are delineated in the Statement of the case, preceding.

ARGUMENT

THERE IS NO FEDERAL QUESTION

THERE IS NO SUBSTANTIAL FEDERAL QUESTION

THE JUDGMENT RESTS ON AN ADEQUATE NON FEDERAL BASIS

THE QUESTIONS ON WHICH THE CAUSE DEPENDS ARE SO UNSUBSTANTIAL AS NOT TO NEED FURTHER DISCUSSION

All of the above grounds will be argued together. There are essentially only one constitutional amendment, CCXII, Constitution of Alabama 1901, supra; one statute, Section 402, supra, and one regulation, 402.2, Income Tax Laws, State of Alabama which govern the issues in this case. There are two cases by the Alabama Court of Civil Appeals which have construed the

amendment, the statute and the regulation. The instant case **Western Grain Company v. State,** 318 So.2d 719, is one of the two cases and the case of **Standard Oil of Kentucky v. State,** 297 Ala. 3, 313 So.2d 532 is the second. Certiorari was denied in both cases by the Supreme Court of Alabama.

There are also two additional cases where similar issues have been raised. The first is that of **Trunkline Gas Company v. Collector of Revenue,** 182 So.2d 674, cert. denied, 248 La. 1101, 184 So.2d 25, and the second is that of **Cities Service Gas Company v. McDonald,** 204 Kans. 705, 466 P.2d 277.

The Alabama Court of Civil Appeals considered and construed Amendment CCXII supra, in its opinion (Jurisdictional Statement, Appendix A(2) pp. 3-4). The Court stated, in part, as follows:

> "The taxing authority of the State in this case is derived from Constitutional Amendment CCXII adopted December 10, 1963 which is as follows:
>
> 'State tax on net income of corporations.--The legislature shall have power to levy and provide for the collection of taxes for state purposes on net income of corporation, from whatever source derived, for the calendar year 1963, or for any fiscal year beginning in the calendar year 1963, and each year thereafter, at a rate not exceeding five percent. **However, all federal income taxes paid or accrued within the taxable year by corporations shall always be deductible in computing net income taxable under the income tax laws of this state, provided that in the case of foreign corporations the amount of federal income tax deductible shall be in proportion to income derived from sources within Alabama, to be determined in accordance with such laws as the legislature may enact.'** (As proposed by Act 91, Laws, 1963, 2nd Spec. Sess., and adopted at the election of December 10, 1963.) (Emphasis supplied.)"

The Court recognized the constitutional issue raised by Western Grain. The same issues without reference to the constitutional question had been postulated in the case of **Standard Oil of Kentucky v. State,** supra. The Court of Civil Appeals determined the Standard Oil case on adequate state grounds and in the outset of the opinion in the Western Grain case stated, in part, as follows: (Jurisdictional Statement, Appendix A(2) pp. 1-2)

> "There are three cases, one for each tax year, which were consolidated for trial and this appeal. Substantially the same issues of law are involved here as were considered by this court in the recent case of **Standard Oil of Kentucky (Kyso v. State,** _____ Ala. _____, _____ So.2d _____ [Ms. Civ. 526] March 5, 1975. Certiorari was denied by the Supreme Court on May 22, 1975. We find that disposition of this case is controlled by our decision in **Kyso except for the issue of constitutionality which we will discuss later in this decision.** (Emphasis supplied.)

The Court likewise found adequate state basis for finding in favor of the state in the Western Grain opinion as follows: (Jurisdictional Statement, pp. 7-10)

> "This court in the Kyso case held that amendment CCXII to the Alabama Constitution is to be construed in light of statutes and regulations relating to the same subject, i.e., Title 52, Sec. 402(13), Regulation 402.2, deductions of federal income taxes. We said,
>
> '. . . . .We interpret the phrase "paid or accrued" to mean the amount paid from the parent to the IRA. . . To this court no federal income taxes were actually "paid" or "accrued" by Kyso by the filing of an accounting statement with Socal.'
>
> We follow our construction of Amendment CCXII in **Kyso** in this case through Western, in bookkeeping terms accrued on its books a calculated federal income

tax which it would have been due to pay had it not chosen to use the consolidated return, it, in fact, did not pay such sum to the Internal Revenue Service nor did it incur liability for such payment. Such tax in terms of actual liability to the taxing authority did not accrue. The severable liability of the members of the affiliated group extends only to the tax due under the consolidated return. **IRS Reg.** Sec. 6(a) 1.1502.

Appellee quotes from Vol. 8A, Mertens Law of Federal Income Taxation, Sec. 46.77, as follows:

'In computing separate taxable income of a member for use in the computation of consolidated taxable income under Regulation 1.1502-11 the starting point is a computation in accordance with the provisions for determining taxable income of separate corporations, with a number of specified exceptions.'

This quotation was given in support of the proposition that each member of the group consolidated for report of income and payment of taxes is the taxpayer and the amount of tax computed on its own taxable income and shown as accrued thereon is tax imposed upon it by the United States. We cannot agree such is, in fact, the case. Of course, the beginning point of a consolidated return is the sum of the taxable income of each member. Such is the case in the consolidated or joint return of a husband and wife. The taxable income of a group cannot be computed without first determining the taxable income of each member thereof. Each member of the group is a reporting unit insofar as its taxable income is determined, and all are severally liable for the tax due under the consolidated return, but there is no liability incurred, paid or accrued by a member of the group according to its separate taxable income. Removal of such liability is one of several benefits derived from joining in a consolidated return.

We interpret the phrase 'paid or accrued' contained in the constitutional amendment to mean actually paid or a liability to pay. When filing a consolidated return the tax which would have been paid or accrued by a member

had it not joined the group is not determined nor is it necessary to be determined, except as required by the agreement between the parent and the members of the group. No such liability is ever incurred or accrued insofar as the taxing authority is concerned."

The federal constitutional question was disposed of by the Court of Civil Appeals in the Western Grain opinion in the following language: (Jurisdictional Statement, Appendix A(2) pp. 10-12)

> "Western contends that the application of the amendment and regulations in such manner is discriminatory as to corporations who choose to join in consolidated returns and is constitutionally impermissible.
>
> We are unable to perceive any discrimination. Every foreign corporation earning income in Alabama is taxed the same--upon taxable income after deduction of federal income taxes paid or accrued. The decision to join in a consolidated return for federal income taxes or file a separate return is that of the taxpayer. Filing a consolidated return is a privilege and results in a consolidated tax liability. 26 U.S.C.A. §1501. If it benefits in relief from federal taxes it may cost in the amount of deductions permitted by the State. Such results in a penalty by choice of the taxpayer. It is not discrimination by the State. We are cited to no case in point to the contrary."

The statute, Section 402(13), supra, which was construed in the Western Grain opinion provides that:

> **"In the case of foreign corporations doing business in this state the deductions allowed by this section shall only be allowed if and to the extent that they are connected with income arising from sources within the state of Alabama, and the proper apportionment and allocation of deductions with respect to the sources of income within and without the state of Alabama shall be determined under the rules and regulations prescribed**

by the department of revenue, provided, that in the case of a corporation doing a business partly within and partly without the state where revenue is apportioned or allocated to Alabama the expense in connection with such apportioned or allocated revenue shall be likewise apportioned or allocated to the state, for the purpose of deductions under this title, or the ratio that company expenses in Alabama bear to the company revenues in Alabama."

In the implementation of Section 402, supra, the Department of Revenue promulgated Regulation 402.2, Income Tax Laws and Regulations, supra. The Regulation provides as follows:

> "A foreign corporation doing business in Alabama is entitled to the same deductions allowed a domestic corporation, but only to the extent that they are connected with income arising from sources within the State. **A corporation having income from multistate operations may apportion its income in accordance with Reg. 398.2, in which case allowable deductions must also be apportioned in the same manner;** or such corporation may adopt a method of separate accounting, in which case the deductions allowable shall be those applicable to the income arising from sources within the State of Alabama.
>
> "Where a corporation operates both within and without Alabama and its books are kept so that its gross income in Alabama is determined without allocation, administrative and other apportionable expenses may be allocated to Alabama in accordance with the ratio of Alabama gross income to total gross income. The amount of Federal income tax allocated to Alabama should be determined by the ratio that the net income from sources within Alabama bears to the total net income from all sources as shown by the Federal income tax return. **The Federal income tax to be apportioned in this manner is the tax accrued as shown by the final Federal income and excess profits tax return of the taxpayer and reduced by any refund allowed and given during the tax year under the Federal statute. Such refund need not be included in**

> **income when apportionment is made in this manner."** (Emphasis supplied)

The amount of federal income tax allowed as a deduction under the Alabama Constitutional provision, implementing statutes and regulations is "the tax accrued as shown by the final Federal income and excess profits tax return." Obviously the amount as final is that sum which is owed after all deductions and credits have been computed. The Court of Civil Appeals of Alabama in both the instant case and the Standard Oil case, supra, found that the first return was that filed by the parent with the I.R.S.

The case of **Trunkline Gas Company v. Collector of Revenue,** 182 So.2d 674, cert. denied, 248 La. 1101, 184 So.2d 25, appears to State's counsel to be the earliest judicial statement in the United States on the present controversy. The case clearly supports the position of the State of Alabama. Because of its pertinence, counsel for the State quotes at length from the **Trunkline** case.

The syllabus states the matter succinctly and demonstrates the similarity between the Louisiana case and the instant case in controversy as follows:

> "Delaware corporation, which did business in Louisiana, brought suit against the Collector of Revenue for review of decision of Board of Tax Appeals. The 19th Judicial District Court, Parish of East Baton Rouge, Jess Johnson, Jr., entered a judgment adverse to the Collector of Revenue, and he appealed. The Court of Appeal, Bailes, J., held that payment by parent corporation of federal income taxes on consolidated return which accounted for and included net income of some affiliates, including Delaware corporation doing business in Louisiana, as well as operating losses of other affiliates, all wholly owned by parent, was not payment in fact of federal

income taxes by Delaware corporation within contemplation and intendment of Louisiana statutes so as to entitle Delaware corporation to full credit reduction for Louisiana state income tax purposes of federal income taxes of Delaware corporation attributable to Louisiana derived income which Delaware corporation computed to be due federal government as though Delaware corporation were paying federal income tax on basis of separate tax return."

Louisiana had a regulation at the time the tax controversy arose in the above case governing the filing of a consolidated return by a parent when an affiliate was doing business in Louisiana. The Court of Civil Appeals of Alabama in both Western Grain, supra, and Standard Oil, supra, determined that Regulation 402.2, supra, implemented the Alabama statute, Section 402(13), supra, even as the Louisiana statute had been implemented by regulations.

The Court in the Louisiana case, supra, stated the contentions of the parties in the Louisiana controversy. The contentions of the Collector of Revenue of Louisiana were as follows:

"1. There is no conflict between R.S. 47:55 and R.S. 47:241;

2. The calculation of a separate federal tax return is not payment of federal income taxes within the meaning of the above two statutes; and

3. The federal income tax deduction allowed on Louisiana income to nonresident foreign corporations in an equitable pro rata share of the consolidated federal income tax paid."

Trunkline's contentions were as follows:

"1. Trunkline Gas Company did actually pay the amount of federal income tax for which it claims deduction; and

2. ITR 55.2 is not in accord with the provisions of R.S. 47:241, et seq., relating to the determination of net income of foreign corporations having Louisiana income."

In disposing of the contention of Trunkline in regard to the conflict between Internal Revenue Regulation 55.2 and Revenue Statute 47:241, the Court state in quoting from the case of **Collector of Revenue v. Hunt**, 246 La. 605, 165 So.2d 843 as follows:

" 'Section 55 [referring to R.S. 47:55 (4)] prohibits the deduction of income taxes paid on net income on which no Louisiana income tax has been paid or will be paid. Moreover, Section 241 provides that the amount of federal income tax to be deducted shall be that portion of the total federal tax 'which is levied with respect to the particular income derived from sources in this state.' Hence, the law is clear that the deductible federal income tax is that paid on state-taxed income.' "

The pith of the opinion in **Trunkline**, supra, was as follows:

"We find, and so hold, that the payment by the parent company, Panhandle Eastern Pipe Line Company, of federal income taxes on a consolidated return which accounts for and includes net income of some affiliates, including Trunkline Gas Company, as well as operating losses of other affiliates, all wholly owned by the parent company, is not payment in fact of federal income taxes within the contemplation and intendment of LSA-R.S. 47:55, 47:241 as to entitle Trunkline Gas Company to full credit deduction of the federal income tax attributable to Louisiana derived income which it computes to be due the federal government as though it were paying this tax on the basis of a separate tax return. On this premise, it conclusively appears to us that the manner of allocating the portion of federal income tax to which Trunkline is entitled to deduct in arriving at net income produced from the designated Louisiana sources as prescribed by ITR 55.2 results in a credit of

an equitable pro rata share of the consolidated federal income tax paid." (Emphasis supplied)

The case of **Cities Service Gas Company v. McDonald**, 204 Kan. 705, 466 P.2d 277, is the exact reverse in its conclusions insofar as counsel for the State can determine. Stated cogently, the Supreme Court of Kansas holds that a member of an affiliated group can deduct what it pays to the parent corporation regardless of what the parent pays to the I.R.S. on a consolidated return on behalf of the group. The Kansas court determined that the **Cities Service** case was different from the Louisiana case, supra, because in Louisiana the Collector of Revenue had promulgated a regulation governing the filing of a consolidated return and in Kansas no such regulation had been promulgated. However, it is obvious that the Kansas court determined the issue on adequate state grounds and no federal question was involved.

The case of **Standard Oil Company v. State**, 294 Ala. 3, 313 So.2d 532, delved intensively and thoroughly into the issues in the instant controversy. The syllabi in the reported case cogently summarize the holdings in the Standard Oil case and demonstrate how thoroughly the opinion in Standard Oil determines the issues in the present case. In regard to Constitutional Amendment, syllabus 1 stated:

> "Constitutional amendment relating to the deduction of corporate federal income taxes in computing state income tax must be construed in light of Department of Revenue regulation which existed at that time and which concerned the same subject."

In syllabus 3, the fact that the new Constitutional Amendment should not be construed to alter or change drastically an existing system is emphasized as follows:

> "New constitutional provision adopted by people already having well-defined institutions and systems of law should not be construed as intending to abolish the former system, except insofar as it is in manifest repugnance to the new constitution, but such provision should be read in light of former law and existing system."

The fact that filing accounting statements by affiliate with parent did not result in payment or accrual of federal income taxes is set forth in syllabus 4, as follows:

> "Where foreign corporation's subsidiary did not file federal income tax returns but filed accounting statements with parent showing amount subsidiary would have had to pay IRS had it filed with them and parent then filed with IRS the amount of income reported by affiliates, no federal income tax was 'paid or accrued' by subsidiary by filing accounting statements, within constitutional amendment providing that corporate federal income taxes paid or accrued are deductible in computing state income taxes, and subsidiary, in computing state income taxes, was not entitled to deduct amount reported to parent but only a percentage of actual amount of cash paid to IRS by parent."

Syllabus 5, states that payment by affiliate to the parent did not constitute federal income taxes paid within the meaning of Alabama law. The syllabus states:

> "Investment credits allowed under federal tax law to reduce tax liability of corporate taxpayer to IRS did not constitute 'payment' of federal income taxes for purposes of computing deduction to be allowed corporation on state income tax return for federal income taxes paid."

The fact that state law and not federal law should control in deciding the instant case is contained in syllabus 6, as follows:

> "State law and not federal law was controlling in determining whether investment credits allowed under

federal tax law to reduce tax liability of corporate taxpayer to IRS constituted 'payment' of federal income taxes for purposes of computing deduction to be allowed corporation on state income tax return for federal income taxes paid."

The colloquy between counsel for the State and witness for Western Grain, Mr. James W. Robertson (R. pp. 92-95) reveals only accounting statements were filed by Western Grain, the affiliate with the parent, Diversa, and Diversa did not, in fact, pay any income tax to the I.R.S. The colloquy follows, in part:

"Q Now, I want to get to this, Mr. Robertson, and that is specifically what type of return is filed by Western Grain with Diversa?

"A I'm not sure what you mean.

"Q Well, do they file a regular Internal Revenue Service form as though they were making out a separate return that could go into the Internal Revenue Service by itself?

"A It's in effect sort of like that, yes.

"Q **Is it on a federal return form?**

"A **No. The consent is the 851 and the -- then there is no prescribed forms for consolidated returns except they lay out what you're supposed to put in there.**

"Q Right. They file an accounting statement that reflects their income, their deductions and what they would be due to be paid in federal tax if filing separately?

"A Now, restate that.

"Q **They file an income tax statement or they file an accounting statement is what I mean to say in which they show their income, their liabilities, their deductions and likewise the amount of income tax that they would have to pay if they were filing a federal income tax**

return directly with the Internal Revenue Service as an individual corporation and no part of an affiliated group?

"A **Well, they do all but they don't necessarily show the income tax due.**

"Q **They do not necessarily show that. In other words what you're saying is that they may just show their income statement?**

"A **If they didn't pay any income tax to the common parent that wouldn't be any there.**

"Q **I'm going to ask you again: Did Diversa make any payment of federal income tax in the years '64, '65 and '66 to the Internal Revenue Service?**

"A **No.**" (Emphasis Supplied)

The witness for the State, Mr. V. S. McElvy, Supervisor, Corporate Income Tax Section, State of Alabama, on examination by state's counsel after referring to provisions in Section 402(13) and Regulation 402.2, supra, regarding apportionment of income and deductions stated that final return meant final return filed by taxpayer with I.R.S. He likewise gave an expert opinion of accrued as requiring subsequent payment. The colloquy was, in part, as follows: (R. p. 110)

"A The federal income tax to be apportioned in this manner is the tax accrued as shown by the final federal income tax -- final federal income and excess profit tax return of the taxpayer and reduced by any refund allowed and given during the tax year under the federal statute.

"Q Now, Mr. McKelvie, are you familiar as an accountant, are you familiar with the accounting term accrued?

"A Yes, sir.

"Q What is your interpretation in regard to accrual and subsequent payment thereof?

"A Well, an item to be accrued or accruable must be finally determined and fixed. It must not be continued and after it's finally determined and fixed it's accrued at that time. Accrual refers to a time and not an amount.

An accrual of an item can be any amount. It refers to a time and if after you have accrued something that is finally determined and fixed is to be subsequently paid.

The discharge of an accrued item must take place as well as the item becomes finally fixed."

REVIEW OF ADDITIONAL CASES CITED BY WESTERN GRAIN IN SUPPLEMENTAL JURISDICTIONAL STATEMENT (JURISDICTIONAL STATEMENT, PP. 3-4)

A review of the additional cases cited by the Appellant in the Supplemental Jurisdictional Statement reveals that these cases do not come to grips with the issue involved herein; that is, the construction of a state statute and a state regulation by the State Courts, circuit and appellate, in the instances wherein the question presented is the amount of federal income tax to be deducted on the state income tax return by an affiliate corporation where the affiliate files an accounting statement with the parent and the parent files a consolidation of all these statement as a return with the I.R.S.

The cases are concerned with application of federal law to the filing of federal income tax returns.

CASE PRESENTS NO FEDERAL QUESTION

The State like the Appellant, Western Grain, finds no federal cases exactly in point to sustain the state's position that no federal question is presented.

However, the following cases are concerned with the lack of jurisdiction of the federal courts over questions of state or local concern and the refusal of the U.S. Appellate Courts to assume jurisdiction in purely state matters.

The case of **Sadler v. Jester,** 46 F.Supp. 737, states that no federal question is involved where the right to a state office in the State of Texas is contested in the state courts by residents of Texas.

The case of **Phoenix Ins. Co. v. Gardner Treasurer of Kings County New York,** 78 U.S. 204, 11 Wall. 204, 20 L.Ed. 112, (1871) although over a hundred years old, appears to not only deny the presence of a federal question in the **Phoenix** case but likewise to cite numerous cases involving the fact of whether a federal question is raised. The most **pertinent** statement in the opinion is as follows:

"Now we have repeatedly held that the construction of a state statute belongs to the state courts, and is not a Federal question which we can revise with a writ of error to a state court. It is true, if the state court gives such a construction to a state statute as to make it conflict with the Constitution or laws of the United States, and sustains its validity after giving it such construction, and thereby deprives a party of his rights under the said Constitution or laws, then a Federal question is raised, and we can review the decision on the point of the validity of the statute."

In the case of **French v. Taylor,** 26 S.Ct. 76, 199 U.S. 274, 50 L.Ed. 189, related to the construction of a state taxing statute and the Court said no federal question was involved unless the statute as construed by the state courts deprived the litigant of property without due process.

In the case of **Hooper v. City of Oshkosh,** 213 N.W. 285, 192 Wis. 523, it was determined that action to recover personal

property tax on ground that Laws 1925, C57, Section 1, repealing personal property tax of 1924 as offset on income taxes, deprived plaintiff of due process in contravention of U.S.C.A. Constitutional Amendments 5 and 14, Section 1, held to involve no federal question. Only a state question concerning a state statute had to be construed by state courts.

In **Dougherty v. Nevada Bank of San Francisco, Cal.**, 16 S.Ct. 258, 160 U.S. 171, 40 L.Ed. 382, refused a writ of error to review a judgment of a state court which had claimed the right to foreclose a municipal tax on street assessment lien on the ground that an extension of time for performance granted after expiration of time limited in contract therefor was invalid. It was dismissed for want of jurisdiction on the basis that no federal question was involved.

Corkran Oil and Development Co. v. Arnaudet, 26 S.Ct. 41, 199 U.S. 182, 50 L.Ed. 143, was concerned with the judgment of a state court denying the right of possession of real property under a title founded on an act of Congress, which rested upon the ground that the title of the adverse party under a tax deed was made good by prescription under the Constitution of the state of Louisiana. No federal question was involved so that a writ of error could be sustained to the Supreme Court of the United States.

CONCLUSION

The cases cited in the Jurisdictional Statement of the Appellant (Jurisdictional Statement, Appendix A(2) p. 7) and in the Supplemental Jurisdictional Statement pp. 3-4 and the cases cited by the State under the heading, There Is No Federal Question are not directly concerned with the issues at hand.

There are four state cases, i.e., the instant case, **Western Grain v. State**, 318 So.2d 719; the case of **Standard Oil of Kentucky v. State**, 294 Ala. 3, 313 So.2d 532; the case of **Trunkline Gas Co. v. Collector of Revenue**, 182 So.2d 674, cert. denied, 248 La. 1101, 184 So.2d 25; and the case of **Cities Service Gas Company v. McDonald**, 204 Kans. 705, 466 P.2d 277, which are concerned with the specific issue herein. The issue is whether a state may by statute provide for a method by which an affiliate filing a consolidated return through a parent deducts its federal tax on its state return on a pro rata basis. In the first two cases above, **Western Grain**, supra, and **Standard Oil**, supra, the Court of Civil Appeals of Alabama found that the state had a statute which covered the question of deduction of federal tax on the state return and that the state had further emphasized and implemented the statute by regulation.

The Supreme Court of Louisiana in the **Trunkline** case, supra, likewise found the statute of Louisiana covered the question of deduction of federal income taxes on the state return and that Louisiana had implemented the statute by a regulation.

The Kansas Supreme Court in the **Cities Service** case, supra, found that the statute in Kansas had not been implemented by regulation. This lack of implementation appears to have been the primary reason for deciding that Kansas did not provide a method for deduction of federal taxes on the Kansas income tax return on a proportional basis.

The above cases sustain the State's grounds for affirmation of the final judgment and decree of the Alabama Court of Civil Appeals, (Jurisdictional Statement, Appendix A(2)), and the denial of certiorari (Jurisdictional Statement, Appendix A(4))

and in the alternative to dismiss the appeal (Jurisdictional Statement Appendix C(1)) filed with this Honorable Court.

The opinions in the four cases decide the issues on adequate state basis, without resort to a federal question and after reading the above opinions, it is obvious that the questions presented in the jurisdictional statement are so unsubstantial that no further argument is warranted.

Also the seven questions postulated by counsel herein, above, are answered by the opinions in the above four cases. The opinion of the Court of Civil Appeals was in no way repugnant to the U.S. Constitution nor the Alabama Constitution (Question 1). The Alabama Constitutional Amendment, CCXII, supra, is fairly and equitably applied to a corporation, Western Grain, in a class and all others in the class are dealt with in the same manner. (Question 2.)

The statute, Section 402(13), supra, and the implementing regulation, 402.2, supra, are fair and equitably applied in the Court's opinion to the Appellant. It is required to apportion its income to Alabama and it is allowed to deduct its federal income tax on a proportionate basis when filing its state income tax return. (Question 4, 5 and 6)

The opinions in the above cases disclose a basic state question, involving state law, decided by the state courts fair and equitably and there remains no substantial question to be decided; therefore, the jurisdiction of the Supreme Court of the United States is not invoked.

The appeal of Western Grain, (Appendix C(1) Jurisdictional Statement) should be dismissed and the opinion of the Court

of Civil Appeals of Alabama (Appendix A(2), Jurisdictional Statement) and the Denial of Certiorari by the Alabama Supreme Court (Appendix B(1) Jurisdictional Statement) should be affirmed.

Respectfully submitted,

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PROOF OF SERVICE

I, James R. Payne, one of the Attorneys for the Appellee, State of Alabama, in this cause, hereby certify that on the 20th day of February, 1976, I served copies of the foregoing motion to affirm or motion to dismiss on Honorable Morris K. Sirote, Sirote, Permutt, Friend & Friedman, 2030 First Avenue No., Birmingham, Alabama, as Counsel for the Appellant, Western Grain Company, by mailing a copy of same to him in a duly addressed envelope, with first class postage prepaid, United States mail.

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